

## IRS Assault on Trust Resources

*A Look Into Recent IRS Efforts to Tax Trust Per Capitas and The Events That Led to The IRS' Partial Concession in Notice 2012-60*

By

Wendy S. Pearson  
PEARSON LAW OFFICES, P.S.  
216 First Avenue So, #310  
Seattle, WA 98104  
425-512-8850  
[wendy.pearson@wspearson.com](mailto:wendy.pearson@wspearson.com)  
[www.wspearson.com](http://www.wspearson.com)

The IRS has a new target for imposing federal tax in Indian Country – trust resources. For the last couple years, the IRS has been attempting to tax tribal members from two Northwest tribes and a Southeastern tribe on their per capita share of revenue generated from their tribal trust resources. This is the first time in the history of these tribes, and probably the history of any federally recognized tribe, that the IRS has asserted that resource revenue held in trust is taxable when distributed per capita. This article will provide the reader with some background on this tax controversy, and describe the events that have led to at least a partial concession from the IRS on this issue, as reflected in their recent Notice 2012-60. As of the date of this article, the issue is not fully resolved.

### 1. The Basic Legal Arguments in Controversy

The fundamental argument the IRS has posed for its new assault on tribal trust resources is that neither federal law nor treaty rights protect revenue directly derived from *unallotted* tribal trust resources from taxation once it is distributed to tribal members.<sup>1</sup> By all accounts, this is a shift in IRS enforcement as both the Office of Special Trustee (OST) and tribes have been making per capita distributions of trust revenues for decades, un-assailed by the IRS. Tribes have consistently maintained that both federal law and treaty rights, where applicable, protect their trust resources. And, further, that Congress confirmed the tax exempt status of trust resource revenue distributed per capita to tribal members in the Per Capita Act of 1983.

The Per Capita Act, 25 U.S.C. Sections 117a through 117c, provides authority for Indian tribes to make per capita payments of tribal trust funds directly rather than from federal trust

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<sup>1</sup> The IRS concedes that *Squire v. Capoeman*, 351 U.S. 1 (1956) protects the revenues derived from *allotted* land from federal taxation.

accounts. In Section 117b, Congress confirmed the continuing tax exemption and resource exemption of these trust fund payments by stating as follows:

(a) Previous contractual obligations; tax exemption

Funds distributed under sections 117a to 117c of this title shall not be liable for the payment of previously contracted obligations except as may be provided by the governing body of the tribe and distributions of such funds shall be subject to the provisions of section 7 of the Act of October 19, 1973 (87 Stat. 466), as amended [25 U.S.C. §1407].

The cross-referenced provision follows:

25 U.S.C. § 1407 – Tax Exemption; Resources Exemption Limitation

None of the funds which - (1) are distributed per capita or held in trust pursuant to a plan approved under the provisions of this chapter ... including all interest and investment income accrued thereon while such funds are so held in trust, shall be subject to Federal or State income taxes nor shall such funds nor their availability be considered as income or resources nor otherwise utilized as the basis for denying or reducing the financial assistance or other benefits ... .

(25 U.S.C. § 1407 is referred to as the “Judgment Distribution Act). The committee reports accompanying the Per Capita Act, likewise, support the continuing tax exempt status of these trust fund payments. The House Report provides:

Section 2(a) [codified in 25 U.S.C. § 117b] provides that funds distributed pursuant to this legislation . . . shall be subject to the provisions of section 7 of the Judgment Distribution Act with respect to tax exemptions and eligibility for government benefits. . . .

H.R. Rep. No. 652, 97th Cong., 2d Sess. 3 (Jul. 22, 1982); see also S. Rep. No. 659, 97th Cong., 2d Sess. 2 (Sep. 8, 1982) (same language).

The IRS disagrees with a plain language reading of these statutory sections, as well as the legislative history of the Per Capita Act, both of which by their terms state “none of the funds” are subject to tax or included in income as an available resource. The IRS contends that the tax exemption and resource exclusion applies only to judgment funds held in trust, not all trust funds. What the IRS legal position means is that not only may federal income tax be imposed on payments from tribal trust resources, but also those payments should be considered an available resource for purposes of determining the eligibility of Indian people for federal programs.

This legal position put the IRS in direct conflict with other federal agencies such as the Social Security Administration, Health and Human Services, Department of Agriculture, and other agencies who interpret the tax exemption and resource exclusion language in the Per Capita Act to apply to all funds held in trust and distributed per capita. It also seemed to throw a wrench into the trust case mismanagement settlements inspired by the Settlement Proposal of Obama Administration (“SPOA” settlements) by calling into question the tax status of those trust case settlements to the extent they are distributed to tribal members.

## 2. Events Leading to an IRS Partial Concession in Notice 2012-60.

Given this apparent shift in tax policy by the IRS, the Northwest tribes who were impacted by the IRS position, in collaboration with the National Congress of American Indians (NCAI), sought to raise awareness of the IRS’ new efforts to tax trust resources. Government to government consultation with Congressional representatives, Department of Interior, and other federal agencies was sought under the authority of Executive Order 13175. Government to government consultation with the IRS and Treasury was also sought, but denied.

NCAI and Affiliated Tribes of Northwest Indians (ATNI) each passed resolutions in Spring 2012, calling for the immediate halt of what they considered to be unlawful actions by the IRS to tax trust resource per capita distributions. Tribes in the throes of settling their trust mismanagement cases with the U.S. government were made aware of this new tax issue and they too pressed Department of Justice and IRS to resolve the matter as to the trust settlements.

Direct support of the Northwest tribes’ legal position was also sought from Department of Interior. After all, OST had been making per capita payments for decades without issuing Forms 1099 to tribal members based on a 1957 opinion of the Solicitor that the trust per capita payments were not taxable. So, the IRS position would now require OST to issue Forms 1099 for trust distributions that they were still making. The Solicitors’ office agreed to engage the IRS in discussions on the issue.

The Northwest tribes also reached out to Senate Indian Affairs Committee (SIA), whose members were scheduled to conduct a hearing on June 14, 2012 on “New Tax Burdens on Tribal Self-Determination.” The SIA agreed to add this issue of taxing capita distribution of trust resources to the agenda, and to ask the IRS to grant consultation. In testimony before SIA, the IRS maintained its legal position that the Per Capita Act does not apply and, therefore, does not confirm the tax exempt status of all trust resource revenue distributed per capita. The IRS further testified that per capita payments of revenue derived from tribal trust

land have always been taxable under the *Capoeman* reasoning and, thus, this is not a tax policy shift for which government to government consultation is required.

After the Senate hearings, the Solicitors Office, IRS and Department of Treasury convened a meeting to discuss the trust per capita issue, but did not invite the tribes who were directly impacted by the tax issue. NCAI attended this meeting to urge Treasury and IRS to reverse their position, stressing the impact on not only taxation but also federal assistance eligibility. Department of Justice representatives were also at this meeting and expressed concern that the IRS position on taxation could undermine the pending trust case settlements.

While Treasury and IRS engaged in intra-agency consultation and deliberation on the trust per capita issue, the Northwest tribes pushed for more Congressional oversight of this issue. By late August, 2012, the Northwest tribes convinced the House Natural Resource Committee, Chaired by Washington's Doc Hastings, to convene an oversight hearing. A hearing was announced by the House Natural Resource Subcommittee on Indian and Alaska Native Affairs for September 14, 2012 to focus exclusively on, "Per Capita Act and Federal Treatment of Trust Per Capita Distributions." The Committee called on both IRS and Treasury to testify, along with the Northwest tribes. Days before that hearing, the IRS issued Notice 2012-60.

Treasury and IRS had hoped their issuance of Notice 2012-60 would moot the necessity of the imminent House oversight hearing. However, Notice 2012-60 addressed itself only to the trust mismanagement cases being settled between the U.S. government and tribes. Notice 2012-60 provides that per capita distribution of trust case settlement proceeds is exempt from tax, as follows:

Per capita payments made from the proceeds of an agreement between the United States and an Indian tribe settling the tribe's claims that the United States mismanaged monetary assets and natural resources held in trust for the benefit of the tribe by the Secretary of the Interior are excluded from the gross income of the members of the tribe receiving the per capita payments.

Therefore, the House Subcommittee on Indian and Alaska Native Affairs remained keen to query the IRS about Notice 2012-60. The Committee asked why the IRS issued guidance limited only to the trust case settlement proceeds and why all distributions of trust revenues are not considered tax exempt under the Per Capita Act. In answer to these queries, the IRS testified, "the legal reasoning of Notice 2012-60 supports a position that those payments [timber revenue distributed per capita] are not subject to tax." Upon additional questioning the IRS clarified further, "if the tribe is making payments under the Per Capita Act from trust assets, those payments are not taxable." When pressed to take an official position on the

record, the IRS demurred and said that it would issue further guidance on the comprehensive question of whether all distributions from trust are tax exempt.

The statements of the IRS at the House oversight hearing are the opinion of the Director of Indian Tribal Governments, Christie Jacobs, and are not the official position of the IRS. And, the additional guidance promised by the IRS has not yet been issued. So, as it stands now, only trust case settlement proceeds distributed per capita to tribal members are tax exempt. Per Capita distribution of trust resource revenue is taxable according to the IRS until their official position is changed, if at all. However, until the guidance is forthcoming, the IRS has suspended any further audits of tribes on this issue.

### 3. What Does Notice 2012-60 Do to Resolve the Trust Per Capita Issue

Notice 2012-60 is limited to trust case settlement proceeds, but as Ms. Jacobs testified, its legal reasoning supports a conclusion that all trust revenue distributed per capita is tax exempt under the Per Capita Act. When describing the reason that the Per Capita Act exempts trust settlement distributions, the IRS cites to the same statutory and legislative history argued by NCAI and the tribes, which provides that per capita distributions of tribal trust revenue “shall be subject to the provisions of [Judgment Distribution Act] with respect to tax exemptions.” Contrary to the position they took just months before in the Senate oversight hearing, the IRS concedes in Notice 2012-60 that the Per Capita Act is controlling and that the referenced tax exemption provision of the Judgment Distribution Act applies to all funds held in trust, not just judgment funds.

Further, according to the IRS, the trust case settlement proceeds replace income derived from the use of trust land and natural resources that would have been held in trust but for the U.S. government’s mismanagement. The IRS concludes that “per capita payments that an Indian tribe makes from the Tribal trust case settlement proceeds are treated the same as per capita payments of funds held in trust by the Secretary of Interior under 25 U.S.C. § 117a [Per Capita Act].” Thus, by Notice 2012-60, the IRS essentially concedes that funds held in trust can be distributed tax-free under the Per Capita Act and that funds held in trust include revenues generated from the use of trust resources.

Accordingly, based on the legal reasoning of Notice 2012-60, it will be difficult for the IRS to arrive at any official position other than one that exempts per capita distributions of revenue generated from trust resources from federal tax. Both Notice 2012-60 and the testimony of Christie Jacobs at the House oversight hearing are promising and portend a “win” for the tribes on this issue. But, we wait to see.

Please contact Wendy S. Pearson at [wendy.pearson@wspearson.com](mailto:wendy.pearson@wspearson.com), or 425-512-8850, if you have any questions about this article or IRS Notice 2012-60.