THE
**INTERTRIBAL AG COUNCIL**
AND THE
**USDA RISK MANAGEMENT AGENCY**


# 2010 Tax Guide for Native American Farmers & Ranchers


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# WHY TAXES ARE MORE COMPLICATED IN INDIAN COUNTRY

Within Indian Country and among accountants and tax preparers there is confusion about how or if to file Federal tax returns with the Internal Revenue Service (IRS) and if income is exempt or taxable when earned by Indians farming or ranching on reservations and allotments.

As participation in programs managed by the United States Department of Agriculture (USDA) increases, the confusion about taxable income has increased, because the USDA files a Form 1099 with the IRS for each program participant. The Form 1099 reports the social security number and the amount of money paid. The IRS then tries to match the income reported on the Form 1099 to the income reported on the participants' individual income tax return.

Some income derived from the land is exempt from taxation, but it may still be required to file tax returns even if no tax is owed. The IRS always demands that a tax return be filed if income is reported on a Form 1099 – **even if the income is exempt and even if no tax is owed.**

There is widespread confusion about needing to file income taxes and needing to pay taxes. Often people should file tax returns, even though they will not owe taxes. As an example, in the early 1990's Indian agriculture producers in Montana were not reporting agriculture income while next door, the Indian agriculture producers in North Dakota were being held to the principle, "If you own the land, income derived is non-taxable but if you lease the land income derived is taxable." Today, in the cities that surround Navajo Nation, many tax preparers rely on a 1986 IRS letter saying that income derived from the reservation is exempt – and they refuse to file tax returns for Navajos, even if the person has a Form 1099 and must file to report the income and explain why there is no tax owed.

**According to the Internal Revenue Service, income derived from the land is exempt only if the treaty or the allotment act that designated the reservation or allotment contains language that specifically grants a tax exemption. This means that in the IRS view, land on one reservation may produce tax exempt income, and land on a neighboring reservation may produce ordinary taxable income. Likewise, some allotments produce tax exempt income and others produce ordinary taxable income.**

**In order to claim an exemption a taxpayer must cite the specific allotment act or treaty. Other legal opinions regarding sovereignty and taxation have not been accepted by the IRS.**

**Laws and interpretations change, and always depend on facts and circumstances. This guide reflects the IRS position as expressed in Internal Revenue Bulletin 2006-15 and Revenue Ruling 67-284 which remain in effect.**

The prevailing belief within Indian Country is that income derived from trust property is not taxable. Income derived from the land is being reported differently in different regions of the country and in some cases, is not being reported at all. Some individuals and farming businesses in Indian country may have received advice over the years that filing tax returns is not required if the farm or ranch is on trust property. Some individuals may receive advice from tax preparers or others who may not be fully informed on the law or regulations.

As a result, many Indian producers may be placing themselves in jeopardy. The important step to take is to become more knowledgeable about the law and IRS requirements so that you can be better prepared to build a strong business. This Guide was prepared for the purpose of helping Indian people gain a better understanding of these laws.

This project is to bring some clarity to the process for accounting for income derived from the land, income received from USDA programs, and to ultimately put forth a document which will help Indian agricultural producers nationwide. You need not become an accountant with all the latest updates from the IRS, but understanding the basic principles will save you headaches and money. There are some basic principles which must be remembered and are repeated throughout this guide.

1. **If you derive income from the land you must know the language in the reservation treaty or in the allotment act in order to know if the IRS would consider the income to be taxable or tax exempt.**
2. **If you derive income from the land, KEEP RECORDS.**
3. **If you receive a Form 1099 you must file a tax return even if you do not owe taxes. The expenses you paid to receive the income reported on the 1099 are deductions, so your net income may be zero or less – or you may be tax exempt.**
4. **Take your tax work to a qualified tax accountant who is familiar with agriculture. If they are not familiar with Indian tax law, present this guide to them.**
5. **Accountants, if you endeavor to prepare taxes and some of your clients may be Indians, study Indian tax law & IRS Publication 225, The Farmer's Tax Guide.**

## ABOUT THE LAND

In order to understand income derived from the land, it is important to have an understanding of terms utilized in the discussion of Indian land. The following definitions were taken from the work of Indian Land Tenure Foundation and are the accepted definition in Tribal Government or the Department of Interior.

## INDIAN LAND DEFINITIONS

Tribal homelands were originally areas of land held in communal ownership by Indian nations where they could live and self-govern. In the late 1700s, reservations were created through treaties with the federal government or by executive orders.

**Fractionated Land** A trust parcel owned by more than one owner as undivided interests. These single pieces of land often have hundreds of owners which makes it difficult for any one of the owners to use the land (i.e. farming or building a home). This because, by law, a majority of owners must agree to a particular use of the land. Fractionated land is a result of land ownership interests being divided again and again when an owner of the interest dies either with or without a will providing for distribution of the asset per his or her wishes (in the case of a will) or by the rules of intestate succession.

**Undivided Interest** A share of the ownership interest in a parcel of trust land is referred to as an undivided interest. The number of interests grows with the division among heirs of these interests according to state or tribal probate laws. Writing a will for distribution of an owner's interest could help overcome the growth of undivided interest. The income derived from the parcel is divided according to the interest held by an individual. An undivided interest may be a tenancy-in-common, a tenancy with rights of survivorship or other tenancy allowed by the jurisdiction which has oversight of the land.

**Tribally Owned Lands** Land that is owned by a group of Indians recognized by the federal government as an Indian tribe.

**Off-Reservation Trust Land** Off-reservation trust land is land that is protected by the federal government for Indian use. After reservations were created, some tribes and individual Indians were given land to use outside of the reservation boundaries. For example, these pieces of land could be religious sites or pieces of land allotted to individual Indians.

**Federal Trust Land** Indian-owned land, the title to which is held in trust and protected by the federal government. Indian people and tribes have use of the land, but the ultimate control over the land remains with the federal government.

**Fee Simple** The most basic form of ownership. The owner holds title and control of the property. The owner may make decisions about most common land use without government oversight. This ownership is subject to state and local tax.

**Restricted Fee Land** The ownership is the same as fee simple land, however, there are specific government-imposed restrictions on use and/or disposition. An example of a restriction is a conservation easement that runs with the land. This ownership is subject to state and local tax.

**Forced Fee Patents** A forced fee patent is a trust-to-fee conversion without the request or consent of the landowner. Forced fee patents led to the loss of many land parcels through tax foreclosure sales. This was particularly true for Indians serving in the military who were unaware that their land status had changed and taxes were due.

**Checkerboard Effect** Land within reservation boundaries may be in a variety of types of ownership; tribal, individual Indian, and non-Indian, as well as a mix of trust and fee lands. The pattern of mixed ownership resembles a checkerboard.

**IIM Account** Individual Indian Money (IIM) Accounts are fund accounts administered by the Department of the Interior. The funds are deposited into these accounts come from a number of sources including, for example, land-related income from leases, timber harvest or mineral extraction. In general, each Indian person with an undivided interest in trust land holds an IIM account.

**Allotted Land** These are lands that were distributed to individual Indians by the federal government. Generally, the allotments were 40-, 80-or 160-acre parcels of reservation land. Allotted land was commonly held ownership that became individually owned.

**Fee-to-Trust Conversion** Original allotted trust lands that were transferred to fee status by the allottee or the BIA under "forced fee" patent era can be returned to trust status in a fee-to-trust conversion. Tribes or individual Indians can initiate the process on fee lands they already own or lands they acquire.

**Trust-to-Fee Conversion** With the passage of the Burke Act in 1906, Indian lands held in trust were converted to fee status if the Secretary of Interior, in his discretion, determined that the Indian landowner was competent. Today, trust lands can be converted to fee status in 30 days. On the other hand, converting land to trust can take years. Only individual Indian landowners can request a trust-to-fee conversion.

**Assignment** The surface right is owned by the respective Tribe with a use right given to an individual member of the Tribe. The length of time an assignment is granted varies by Tribe and can vary in term from 25 years to 99 years.

## Are Indians exempt from paying federal income tax?

It is a common belief in off-reservation communities that Indians get monthly checks from the U.S. Government and that Indians do not have to pay any income taxes. Both of these beliefs are totally wrong, Indians **do not** get monthly checks just because they are Indian and there are **no exemptions** for an individual based solely on the fact that the individual is an Indian.

**The foundation of the IRS interpretation of the taxability of Indian income is that an "exemption comes from treaties, agreements, and federal tax statutes."**

An Indian does not receive an exemption from income tax just for being Indian. Tax exemption comes only from the land. The IRS position is that income derived from reservation or allotted land is exempt from federal income tax – **if the treaty or allotment act contains language that specifically grants an exemption. This is important because the IRS will ask for the specific treaty or allotment act if it asks for proof of why the income is exempt and not taxable.**

The agreement having the most impact on Indian land ownership is the Dawes Act, also commonly referred to as the General Allotment Act. The Dawes Act contains language that makes income derived from lands allotted under Dawes exempt from Federal taxation.

Passage of Dawes was driven by two factors: 1) In the government's eyes there was the need to assimilate Indians into the general society; 2) Not all Indian Reservations were located on the most desolate lands but in fact were seen as valuable to non-Indian ranchers, farmers, timber harvesters and miners who wanted access to the resources.

The law divided what was owned by the Tribe as a group into individual allotments and the access beyond the needs of the Tribe were opened to the general public. Another important principle of the Dawes Act was Indians receiving an allotment were allowed to live on this allotment for a period of 25 years tax free but after that period trust title to the land would be terminated and a patent-in-fee would be issued. The law also stated that once the patent-in-fee was issued the individual Indian would become a citizen and subject to state and county laws. As an interesting side note, Indians as a group were not recognized as citizens of the U.S. until 1924, which was 37 years after the passage of the Dawes Act. However, the impact to Indian land ownership was devastating as there was over 90 million acres of land ownership that passed from Indian to non-Indian ownership.

Included in the discussion of laws having direct impact on Indian land ownership is the Burke Act of 1907 as it authorized the Secretary of Interior to make a determination as to the

competence of an individual Indian to conduct his/her individual affairs prior to the issuance of a patent-in-fee. The Burke Act also states that every Indian who has taken up residency on their respective allotment is declared a citizen and is afforded the same rights as any other citizen. The Burke Act also speaks to the intended taxability of the land once a patent-in-fee is issued.

Also important to the discussion of the history of the federal governments intent as it dealt with Indian land ownership is the Howard-Wheeler Act or Indian Reorganization Act which basically stopped all further allotment of Indian lands, recognized the trust status of the land, states that purchased trust lands are tax exempt and set up a form of constitutional government for those Indian Tribes ratifying the law.

***A supplement to this document is a list of historical laws that have an impact on Indian land ownership and the allotment of reservations. and a regional list of Indian Reservations depicting which Reservations in that respective region were allotted and the laws under which they were allotted. See Indian Land Tenure Foundation: "Historic Allotment Legislation"***

***It is within the specific allotment laws that provide address of the taxability of income derived from the land. Research done on this project has not revealed any laws specifically offering income exemption for a Tribe or members of that Tribe.***

## What is exempt income derived from the land?

If the reservation treaty or the allotment act includes language exempting income derived from the land from federal tax, then the IRS defines exempt income as including: rents, royalties, proceeds from sales of natural resources, sales of crops grown on the land, grazing income, sales of livestock raised on the land. The IRS has also determined that trust allotted land can be passed through inheritance, gift, and may be purchased while retaining tax exemption.

The following Federal program payments are exempt **if they are received in conjunction with exempt farming and ranching income**: Agricultural Conservation Program; Appalachian Land Stabilization and Conservation Program; Cropland Adjustment Program; Cropland Conversion Program; Conservation Reserve Program; Feed Grain Program; Wheat Program; Upland Cotton Program; Wool and Mohair Program; and Sugar Program.

Regardless of the fact that the income may be exempt, a Form 1099 will be sent to the farmer or rancher and to the IRS. This means that unless the farmer or rancher files a tax return the IRS will assume that the income is taxable, assume that there are no deductions, and send a letter (generally called a "CP-2000" letter) demanding a tax return and full payment of taxes with penalties and interest.

To avoid this, file a Federal tax return any time you receive a Form 1099. If the Form 1099 is for income which you believe to be exempt you may:

1) File a Federal tax return reporting miscellaneous income of zero and attaching a statement explaining the miscellaneous income. This is an example for someone who farms on land allotted under the Dawes Act:

   1099Income received $25,000
   Less: Exempt amount -25,000
   Net taxable income zero
   Explanation: 1099 is for income derived from land allotted under the Dawes Act and is therefore exempt from federal taxation.

2) File a Federal tax return with a Schedule F reporting income and expense from farming and ranching activity. Do NOT carry the net income or loss from the Schedule F to the main tax Form 1040. Write clearly across the top and bottom of the Schedule F: FOR INFORMATION PURPOSES ONLY, ACTIVITY IS EXEMPT ACCORDING TO THE TERMS OF (and then cite the treaty or allotment act.)

Option 1 is useful if you do not regularly farm or ranch for a profit. Option 2 is useful if you are engaged in farming or ranching because you can use the Schedule F Forms which you filed with the IRS to apply for loans or crop insurance, or just to help you stay motivated to keep detailed records so you can monitor your profit and loss.

**If no treaty or allotment act can be cited, the IRS will be unlikely to accept the claim that the income is exempt.** If the income is from land on a reservation with a treaty that does not contain a tax exemption or from land allotted under an Act that does not contain exemption language, then it is subject to all of the same tax rules and regulations as any other income of any other citizen.

**(For specific IRS Rulings see Appendix A)**

# GUIDE TO REPORTING USDA PROGRAM INCOME

**Participation in the following USDA Programs will result in a Form 1099 going to the program participant and to the IRS.**

| *Agency* | *Program Name* | *Program Type Income/Cost Share* | *Issued From* | *Where to reported if filing Schedule F* |
|---|---|---|---|---|
| **Farm Service Agency FSA** | Non-Insured Crop Disaster Assistance Program (NAP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Livestock Compensation Program (LCP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Livestock Indemnity Program (LIP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Crop Disaster Assistance Program (CDP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Emergency Assistance for Livestock & Honey Bees (ELAP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Livestock Forage Disaster Program (LFP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Livestock Indemnity Program (LIP) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Supplemental Revenue Assistance Payments (SURE) | Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Tree Assistance Programs (TAP) | Income | Commodity Credit Corporation (CCC) | **6a & b** |
| | Conservation Reserve Program | Income | Commodity Credit Corporation (CCC) | **6a & b** |
| | Direct & Counter-Cyclical Program (DCP) | Income | Commodity Credit Corporation | **6a & b** |

| | | | | |
|---|---|---|---|---|
| | | | (CCC) | |
| | DCP Wild Rice, Fruit, and Vegetable Provisions | Income | Commodity Credit Corporation (CCC) | **6a & b** |
| | Emergency Conservation Program | Cost Share/Income | Commodity Credit Corporation (CCC) | **8a & b** |
| | Farmable Wetlands Program | Cost Share/Income | Commodity Credit Corporation (CCC) | **6a & b** |
| | GRAZE-OUT Payment Program | Income | Commodity Credit Corporation (CCC) | **6a & b** |
| **Natural Resources Conservation Service (NRCS)** | Conservation Stewardship Program | Income | NRCS | **6a & b** |
| | Environmental Quality Incentives Program | Income/Cost Share | NRCS | **6a & b** |
| | Farmland Protection Program | Income | NRCS | **6a & b** |
| | Grassland Reserve Program | Income | NRCS | **6a & b** |
| | Grazing Lands Conservation Initiative | Income | NRCS | **6a & b** |
| | Wetlands Reserve Program | Income | NRCS | **6a & b** |
| | Wildlife Habitat Incentives Program | Income/Cost Share | NRCS | **6a & b** |
| **Risk Management Agency (RMA)** | Actual Production History | Income | Insurance Company | **8a & b** |
| | Group Risk Plan | Income | Insurance Company | **8a & b** |
| | Dollar Plan | Income | Insurance Company | |

| | | | | |
|---|---|---|---|---|
| | Adjusted Gross Revenue | Income | Insurance Company | **8a & b** |
| | Crop Revenue Coverage | Income | Insurance Company | **8a & b** |
| | Group Risk Income Protection | Income | Insurance Company | **8a & b** |
| | Income Protection | Income | Insurance Company | **8a & b** |
| | Revenue Assurance | Income | Insurance Company | **8a & b** |
| | Livestock Risk Protection | Income | Insurance Company | **8a & b** |
| | Livestock Gross Margin | Income | Insurance Company | **8a & b** |
| **RMA: Examples of Individual Crop Policies** | Cultivated Wild Rice | Income | Insurance Company | **8a & b** |
| | Forage Seed | Income | Insurance Company | **8a & b** |
| | Pasture Rangeland & Forage | Income | Insurance Company | **8a & b** |

## SPECIAL CONSIDERATIONS: QUESTIONS AND ANSWERS

***When a farmer or rancher is working on both kinds of land how much income is exempt?***

There is no mandatory form of statement required, but an allocation of income and expense to exempt land must be reasonable under the facts and circumstances.

**Example 1**: A rancher owns a herd of cattle he operates on two thousand acres of land. One thousand acres is owned as a trust allotment. If the characteristics of all the land are similar, the rancher would exclude one-half the income from the sale of cattle and would not claim a deduction for a half of the expenses. In addition, expenses directly related to the trust land would not be deductible.

**Example 2**: A rancher operates a herd of cattle on one thousand acres of land he owns. Five hundred acres is allotted in trust and contains two hundred acres of irrigated hay land. He also leases from others one thousand acres of grazing land, giving him a total of one thousand eight hundred acres of grazing land. The rancher would allocate an amount of income to exempt status equal to a reasonable sum determined by what portion the allotted land compared to the total land contributed to sustaining the cattle for the tax year. Assuming the hay land produces enough feed to provide for one-half the needs of the cattle when added to the three hundred allotted grazing acres, one-half the amount of the cattle sales would be exempt. In this case, one-half of the un-apportioned expenses would be nondeductible. The apportioned expenses would include operating and depreciation costs of the haying equipment and would be nondeductible. The cost of the lease and any expenses directly related to the non-allotted land would be added to the deductible expenses

***Can I deduct the cost of raising my sheep to get the wool to make the rugs I sell to make a living?***

This answer may sound backwards:
If the sheep business is on land that makes the income exempt then the expenses can NOT be deducted (because if there was income it would not be taxed.)

If the sheep business is on land that does not have an exemption then the expenses CAN be deducted (because if there was income it would be taxed.) It is very important to have records to substantiate that the deductions are associated with the ordinary and necessary cost of raising sheep for wool.

**Example 1:** Mrs. Begay raises churro sheep on the Navajo reservation. She uses the wool in her traditional Navajo rugs. She is a sole proprietor of two businesses: a sheep farm and a rug business. She files both a Schedule F for the sheep farm and a Schedule C for the rug business. All of the expenses for the sheep are shown on the Schedule F. At the end of the year she adds all of the sheep expenses to determine the cost of the wool. She writes a receipt showing that she "sold" the wool from the farm to the rug business. She reports the amount of the sale as income on the Schedule F and as materials expense on Schedule C. The total of all of those expenses is the "cost" of the wool. Here Schedule F always shows that she has zero net income. She follows the regular rules for a manufacturing business or an artist to prepare her Schedule C. She can deduct the cost of the sheep / wool because she ranches on the Navajo reservation and the treaty there does not include language making income derived from the land exempt.

If she ranched on lands allotted under Dawes she would **not** be required to pay taxes on a sheep-wool business, so the IRS may find that she would **not be able to deduct** the cost of

the sheep and the wool from the income from the rugs. This situation has not been fully clarified by the IRS.

***Could she simplify matters and report both activities as part of Schedule F?***

No, agricultural income is subject to different rules than other types of self-employment income. Agricultural income is reported on Schedule F and other self-employment income is reported on Schedule C. [Proposed Treas. Reg. 1.465-43(c)]

***I was told I couldn't file taxes because I was just a hobby – what does that mean?***

The "Hobby Loss" provisions of the Internal Revenue Code § 183 are meant to preclude taxpayers from achieving tax benefits from activities carried on primarily with a non-business view. That is, there is no expectation of profit. "Hobby Loss" activities are usually pleasurable or recreational in nature. Many for profit businesses are also pleasurable or recreational. The line is often blurred. A taxpayer must enter into an activity with the intent of making a profit in order to avoid the "Hobby Loss" provisions. The Internal Revenue Code limits deductions which may be claimed against income of activities not engaged in for profit.

Whether a taxpayer possesses the requisite profit intent is a question of fact. Courts give greater weight to the way a business has been operated compared to a taxpayer's statement that he expected a profit. The Regulations in the IRC contain a list of nine factors to be considered in determining a profit motive. [Treas. Reg. 1-183-2(b)]. Among the factors in the regulations are the expertise, time commitment, financial circumstances, previous experience in the activity, pleasure factor, and asset appreciation potential.

Example 1: Mr. Roy teaches at the local high school and breeds horses on land he owns in fee simple. Each year he makes gifts of horses to friends and relatives. He does not attempt to sell horses. Mr. Roy is engaged in an activity not for profit. **His horse related expenses would generally not be nondeductible – if he wins a prize or happens to sell a horse the income must be reported.**

Example 2: As above, however Mr. Roy attends classes every year to learn how to improve his business, he keeps careful records of how he manages his horses and he records his income and expense. He uses many different methods to let people know that his horses are for sale. Some years he makes a profit, many years he loses money. He is a business, not a hobby, so he files a Schedule F and reports his income and deducts his expenses. He may use his losses to offset his wage earnings, so he pays less tax in years when he loses money.

Example 3: The facts are the same as Example 2, except Mr. Roy's land is allotted under Dawes. In this case the fact that Owner has losses or profits makes no difference in income tax results. His businesses produce tax exempt income, or losses, and are not reported as part of his taxable income. He will receive no benefit from his losses.

***Can I claim the Earned Income Credit if my income is exempt?***

**No.**

The Earned Income Credit is computed on earned income which is subject to taxation – exempt income is not subject to taxation so it cannot be used to calculate the Earned Income Credit. Net earnings cannot be used to increase income to qualify for a higher credit (for

people with very low earned income) and net losses cannot be used to reduce other earned income to qualify for the credit (for people with net income just above the limits.)

The IRS does not provide an option to choose to include tax-exempt income on the return. This prevents the taxpayer from choosing whether to include or exclude income on the tax return based on the most favorable tax scenario.

Military personnel are able to use their tax- exempt active duty income to calculate the Earned Income Credit. This exception was legislated. Before it was legislated many soldiers did not owe income taxes because they qualified for the Earned Income Tax Credit. When these soldiers went on active duty their income became exempt from income tax but instead of paying less tax (because they were already not paying any tax) they lost the benefit of the Earned Income Tax Credit. This is the same situation for many people farming or ranching on exempt trust or allotment land. If you do not make enough income to owe income taxes being exempt from income tax is not a benefit and the exemption may make it harder for you to qualify for the Earned Income Tax Credit. Any changes to this would have to be made through legislation similar to the legislation that helped soldiers to qualify for the Earned Income Tax Credit.

**Example 1 – Exempt Income and no Earned Income Tax Credit:** An Indian husband and wife have a small, tax- exempt farming operation. The wife works in town and receives W-2 wages and some pension income, which are taxable. The farming operation produces a loss for the year, which is exempt.

The couple would not be allowed to choose to file a Schedule F to offset the wage income with the exempt losses. Had the loss been available, it could have reduced the spouse's earned income to the point where an Earned Income Credit could have been taken. Taxpayers may not pick and choose whether or not to recognize tax-exempt income. The couple also loses the reduction to the taxable pension and W-2 wages the exempt loss created.

**Example 2 – Non-exempt Income and Optional Self Employment Method :** A farmer and wife are married with 2 children, both under 17 years of age. They have both tax-exempt and taxable earnings and losses from their farm. The couple has no other income or loss.

The operations on the tax-exempt land generate a gain for the year which is not included on Schedule F. The taxable land operation generates a loss for the year which is included on the Schedule F. The taxpayers could elect the farm method of optional self-employment income subject to the following parameters.

For 2009, one of the two following conditions must be met: the gross farm income must be less than $6,540 or the net income must be less than $4,721. Since they meet the second condition, they can choose to report "Optional Self – Employment income" (per schedule SE, Form 1040 instructions, self – employment) and this amount can be used to qualify for an Earned Income Tax Credit. The couple could also use the optional self employment income to qualify for the Child Tax Credit for their two children. The Optional Self-employment income also qualifies to life-time Social Security earnings.

The IRS has not specifically said if the Optional Self-Employment income can be used by someone farming or ranching on lands that carry an exemption from Federal Income Tax.

***Can I use my losses this year to reduce my taxes last year?***

Net Operating Losses from a trade or business may be carried back to apply against prior income and to deduct from succeeding years' income any unabsorbed loss. Generally, a

farmer may carry back a loss five years while non-farmers carry back two years. If the loss cannot be taken in prior years it may be carried forward to offset future income. In 2009 taxpayers may carry back losses 5 years as a result of the American Recovery and Reinvestment Act of 2009, or forego the 5 year carry back and carry back two years or elect to forgo any carry back and carry forward the loss for 20 years.

Non-exempt business owners may carry back Net Operating Losses to offset income in prior years. This often results in refunds of taxes paid in those prior years. Tax-exempt farmers do not realize this potential benefit. Many exempt small farmers experience losses and cannot utilize Net Operating Losses. Yet when tax-exempt farmers earn profits this income is exempt from taxation thus balancing an apparent inequity.

***I have exempt income, can I still have an IRA and will I still get Social Security?***

Exempt income may prohibit a business owner from contributing to certain retirement plans such as IRAs. Retirement plans generally require the participants to have earned income subject to Social Security in order to contribute. Exempt income is not considered earned income so plans that have this requirement would be unavailable.

The deductions from retirement plans may not play a significant role due to the exempt aspect of the business income. The tax deferral of retirement plans would not be available.

One option to generate earned income to fund retirement is to pay wages to a spouse. This would allow the spouse to contribute to a traditional or Roth IRA (if under the maximum income level). A Simple IRA may also be utilized via contributions through wage deductions.

Exempt income will not count towards your Social Security earnings because you do not pay social security taxes on exempt income, this means that someone who earns their entire living by farming or ranching on exempt trust or allotted lands will not be able to qualify for Social Security benefits, but if the same person were on non-exempt lands they would be able to qualify.

To understand if this is a benefit or a negative, you need to consider if you would have owed income taxes on your farm or ranch earnings, or if you would have qualified for the Earned Income Tax Credit, and you need to compare what you may have saved from not paying taxes to the Social Security benefits you do not have. One additional consideration is if you actually saved the amount you did not pay in taxes. If you do not save that amount that you would have paid in taxes, then you will not have that money or a Social Security benefit when you retire.

## More Questions and Answers

**Question:** *If you are an Indian producer, operating on Indian Trust Land, what do you do with the 1099G for you receive?*

**Answer:** Farm income reported on tax form 1099G should be reported on tax for **Schedule F-Profit or Loss from Farming, Form 1040**. Contact your accountant or tax advisor for further information. There is no provision in the Internal Revenue Code that exempts an individual from the payment of Federal Income Tax solely on the grounds that he/she is an Indian. The IRS position is that income derived from reservation or allotted land may be exempt from federal income tax – **if the treaty or allotment act contains language that specifically grants an exemption.**

**Question:** *Many Tribes including those that were subject to the allotment acts have within their respective "constitutions" the authority to grant assignments to those who either did not receive an allotment or the respective Reservation is owned by the Tribe and grants an "assignment" to an enrolled member of the Tribe. The terms of the assignments vary but for the sake of this question, the assignment is for 99 years in term and can be willed to descendents.*

*An individual Indian operating an agriculture enterprise on an "assignment" received a 1099 from USDA for participation in a USDA conservation program thus must file a Federal Income Tax Return. Is this land considered "owned" by the respective individual thus the income received non-taxable or what is the IRS ruling?*

**Answer:** The taxation concept regarding income earned from allotments as explained in Revenue Ruling 56-342 does not appear to extend to income earned from assignments. In an assignment (as described below), the individual has no ownership interest in the land (either at present or in the future). Therefore, they appear to be similar to a lessee who would have a 99 year lease at no cost. We believe that the IRS would consider income earned from such an arrangement as taxable.

**Question:** *Is farm income generated from soil and water conservation programs and agricultural commodity programs on Indian Trust lands exempt from taxation?*

**Answer:** The IRS position is that income derived from reservation or allotted land is exempt from federal income tax – **if the treaty or allotment act contains language that specifically grants an exemption.** If the Indian operator is farming/ranching on reservation or allotment land that has that specific language, then payments made under programs administered by the USDA for soil and water conservation programs and agricultural commodity programs are considered "derived directly from the land" and tax exempt.

> **Revenue Ruling 69-289**
> Revenue Ruling 69-289 defines gross income from USDA programs on Indian Trust Lands: Payments made under USDA programs having as their general objectives the conservation of soil and water resources, the maintenance of reasonable and stable supplies of agricultural commodities, and the protection of farm income are considered payments "derived directly from the land."
>
> Under USDA programs, payments are made to Indians for agreeing to use the land in certain ways and agreeing not to use the land in certain ways. Therefore, these payments are considered to be income "derived directly from the land" to the same extent as would be rentals or the proceeds of sales of crops grown on the land, and are excludable from Indians' gross income for Federal Income Tax purposes.

Remember, the income may be exempt, but you still have to **report it** somewhere on your tax return and explain to the IRS why it is exempt – that means you have to cite the treaty or the allotment act that makes income derived from the land you farm or ranch exempt from Federal taxation.

**Question:** *What type of income from Indian Trust Land is tax exempt?*

**Answer:** To be tax exempt, income must be derived directly from or directly attributable to the use of the land, such as farming, ranching, hunting and mining. The land must either be Reservation land where the reservation treaty as ratified by Congress explicitly states that income derived from Reservation lands is exempt from Federal taxation, or it must be allotted land issued in an Act of Congress that specifically includes language indicating clear congressional intent that the Indian Trust land is not subject to taxation.

**IRS Revenue Ruling 67-284 states:**

The Internal Revenue Service recognizes the exempt status of income received by an enrolled member of an Indian Tribe where **ALL** of the following five tests are met:

**1**. The land in question must be held in federal trust status by the United States Government;
**2**. Such land must be restricted and allotted land and is held for an individual Indian and not for a tribe;
**3**. The income must be derived directly from the Indian Trust land
**4**. The **statute, treaty, or other authority involved must evidence congressional intent** that the allotment be used as a means of protecting the Indian until such time as that land is removed from federal trust status;
**5**. The authority in question must contain language indicating clear congressional intent that the Indian Trust land is not subject to taxation.

This ruling is also the basis for the IRS requirement that in order to claim the exemption you must be able to cite the **specific** treaty or act which grants the tax exemption.

If all of these five tests are not met, and if the income is not otherwise exempt by law, it is subject to federal income taxation.

Payments or income derived directly from Indian Trust lands that are exempt include:

- Rentals (including crop and grazing rentals);
- Royalties;
- Proceeds from the sale of natural resources on Indian Trust lands and income from the sale or exchange of cattle/livestock raised on these lands; and,
- Income from the sale of crops grown on Indian Trust lands and from the use of these lands for grazing purposes.

**Question:** *So what does this mean?*

**Answer:** Indian producers receiving a Form l099 (or 1099G) for USDA payments from soil and water conservation programs and agriculture commodity programs for the production of crops and livestock on Indian trust land may claim an exemption if:

1. The Indian operator derives income from reservation lands, and the reservation treaty includes language granting tax exemption (or this exemption has been interpreted by Federal courts as intended.)
2. **OR** The Indian operator, is operating on their own allotment and the allotment act includes language granting the exemption.
2. **AND** The income reported on the Form 1099 is from:

- The conservation of soil and water resources, maintenance of reasonable and stable supplies of agricultural commodities, and the protection of farm income.
- Crops, livestock or other agricultural products.

Then the agricultural income "derived directly from the land" may be reported as tax exempt by attaching a statement citing the specific treaty or allotment act that grants the exemption.

**Revenue Ruling 57-523**
Revenue Ruling 57-523 states farm income derived from Indian Trust lands rented by an Indian operator (farm/pasture leases or range unit permits) is not considered income held in trust for or received by the allottee (land owner) and is included in gross income.

**Question:** *An enrolled tribal member has a farming operation on tribal land allotted under Dawes (which contains exemption language.) He owns part of the land (50%) and rents a portion (50%) from his neighbor. The rented land is allotted tribal land owned by an Indian. The farmer receives money from the CCC Loan Deficiency Program and a 1099 is issued to him. He has both rented and owned land enrolled in the program from which the income is equally derived. How is this income reported?*

**Answer:** Income from the owned land is excludable from gross income (Revenue Ruling 63-244) while the income attributable from the rented land must be included in income. The recipient of the 1099 needs to allocate the income between owned and rented land. In this example it would be split 50% - 50%. Detailed records are vital to the accurate and correct reporting of income for taxation purposes.

The IRS has a 1099 matching program which means the IRS looks for the 1099 amounts to be reported by the recipient on their tax returns. Even though the 1099 amounts received may not be included in taxable income, they must be reported. In the example given, the farmer would report the 1099 income either as miscellaneous income of zero or on a Schedule F that carried zero income to the Form 1040. In either case the farmer must attach a statement with an explanation for why the reported income is zero instead of the amount shown on the 1099 and a statement citing the treaty or allotment act that makes the income exempt. It is common practice to report exempt income on appropriate schedules of the tax return, then deduct on the same schedule any profit from the activity as exempt. The important thing is to clearly explain why the exempt income is being deducted.

**Question:** *A Rancher operating on a reservation slaughters two yearling steers that he held over from the prior calf crop. He has them processed and sells one to his neighbor. He sells the other to an acquaintance in the city, which is off of the reservation. Is this taxable income?*

**Answer:** The sale of both steers would be exempt income if the reservation treaty included language that intended to make the income tax exempt. The product sold is directly tied to the land.

**Question:** *A rancher is showing a loss on his on his operation. The family has some other modest income that is not exempt. The ranching income would not be exempt should a tax return be filed. The rancher is wondering if he should even bother filing since he will show a small loss anyway. What are his options?*

**Answer:** The Earned Income Credit is available to taxpayers who meet certain income criteria. The rancher could receive a refund if his income or loss meets certain parameters. This is designed for people with low incomes and could result in a refund.

The rancher could elect to report self-employment income using the optional method using Schedule SE. This creates a small, artificial gain when there is really a loss. It can help trigger an Earned Income Credit by boosting the taxpayer into the required bracket.

If the ranch was exempt, the rancher could not claim the Earned Income Credit.

**Question:** *An enrolled member of a tribe owns 100% of an allotment located on the reservation which she is enrolled in. However, she resides on another reservation. Her land is enrolled in CRP and she receives a 1099G every year from her CRP payments.*

**Answer:** Residency on the reservation where the allotment is located is not required for an allottee to claim exemption of income from her allotted land. The income listed on the 1099G is exempt and would not have to be reported. She could use the reporting method described in example #2.

**Question:** An *individual Indian owns 100% of his farmland, and because of drought received a payment from the Non-Insured Crop Disaster Assistance Program (NAP). How is this reported?*
**Answer:** The same reporting methods as in the previous example apply.

**Question:** *Same 2 questions as above but he has his crop insured through the Federal Crop Insurance program?*
**Answer:** The same reporting methods as in the previous example apply.

# *Appendix A*

# IRS RULINGS

## Revenue Ruling 56-342

SECTION 61. - GROSS INCOME DEFINED

Income held in trust for or received by the patent holder which is derived directly from allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, 24 Stat. 388, as amended, 25 U.S.C. 348, is exempt from Federal income tax. *Squire* v. *Horton Capoeman et ux.,* 351 U.S. 1, Ct. D. 1796, C.B. 1956-1, 605. Such exempt income includes rentals (including crop rentals), royalties, proceeds of sales of the natural resources of such land, and income from the sale of crops grown upon the land and from the use of the land for grazing purposes. Such income is not includible in computing net earnings from self-employment for the purpose of the tax imposed by the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

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## Revenue Ruling 62-16

Section 61 – Gross Income Defined
1962-1 Cumulative Bulletin 7
**Caution: Modified by Revenue Ruling 74-13**
**Caution: Modified by Revenue Ruling 67-284**

The proceeds from the sale or exchange of cattle and other livestock raised by an Indian on his allotted and restricted lands while such lands are held for him by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, are exempt from income tax, with a specified exception.

Revenue Ruling 58-64, C.B. 1958-1, 12, and Revenue Ruling 60-377, C.B. 1960-2, 13, revoked; Revenue Ruling 56-342, C.B. 1956-2, 20, amplified.

Revenue Ruling 56-342, C.B. 1956-2, 20, which is based upon the decision of the Supreme Court of the United States in Squire v. Horton Capoeman et ux., 351 U.S. 1, Ct. D. 1796, C.B. 1956-1, 605, holds that income held in trust for or received by the patent holder which is derived directly from allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act, 25 U.S.C. 348, as amended, is exempt from Federal income tax. In interpreting the Capoeman decision, that Ruling holds that such exempt income includes rentals (including crop rentals), royalties, proceeds of sales of the natural resources of such land, and income from the sale of crops grown upon the land and from the use of the land for grazing purposes.

Revenue Ruling 56-342 was amplified by Revenue Ruling 58-64, C.B. 1958-1, 12, which holds that the term “income from the use of the land for grazing purposes” in Revenue Ruling 56-342 does not refer to income received from the sale of cattle raised on the allotted lands.

The effect of Revenue Ruling 58-64 was to deny a tax exemption to Indians who raise cattle and other livestock on their own allotments, while Indians who lease their allotments were entitled to treat their grazing fees as exempt income under Revenue Ruling 56-342. Revenue Ruling 58-64 accordingly was modified by Revenue Ruling 60-377, C.B. 1960-2, 13, which allows an exemption for certain proceeds from the sale of livestock but only to the extent of an amount equivalent to the grazing fees that the holder of the trust allotment might have received had the land been leased for grazing purposes.

Upon further consideration and in view of the difficulties under the formula set forth in Revenue Ruling 60-377 in allocating the portion of livestock sales proceeds attributable to the land and the portion attributable to other factors, such as labor, the use of equipment, and the like, the determination has been made to treat the full sums received as “derived directly” from the lands within the meaning of Revenue Ruling 56-342, just as in similar circumstances, under the Ruling, proceeds from the sale of crops grown upon trust allotments are so treated.

Accordingly it is held that income held in trust for or received by an Indian from the sale or exchange of cattle and other livestock raised on his allotted and restricted Indian lands while such lands are held in trust for him by the United States, as trustee, in accordance with section 5 of the General Allotment Act is exempt from Federal income tax. Unless otherwise provided by law, the exemption described herein will not be applicable in those instances where the Indian has obtained his interest in the exempt lands through an arm’s length purchase rather than, for example, through allotment, gift, devise, or inheritance.

Revenue Ruling 58-64, C.B. 1958-1, 12, and Revenue Ruling 60-377, C.B. 1960-2, 13, are hereby revoked, and Revenue Ruling 56-342, C.B. 1956-2,20, is amplified.

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# Revenue Ruling 67-284

SECTION 61. - GROSS INCOME DEFINED
26 CFR 1.61-1: Gross income.
1967-2 Cumulative Bulletin 55; Revenue Ruling 67-284
July, 1967

Principles applicable to the Federal income tax treatment of income paid to or on behalf of enrolled members of Indian tribes.

Revenue Ruling 62-16, Cumulative Bulletin 1962-1, 7, modified.

The Internal Revenue Service has been requested to set for the general principles applicable to the Federal income tax treatment of income paid to or on behalf of enrolled members of Indian tribes.

I. *General Tax Status of Indians.*

There is no provision in the Internal Revenue Code of 1954 which exempts an individual from the payment of Federal income tax solely on the ground that he is an Indian. Therefore, exemption of Indians from the payment of tax must derive plainly from treaties or agreements with the Indian tribes concerned, or some act of Congress dealing with their affairs. See Revenue Ruling 54-456, Cumulative Bulletin 1954-2, 49, and the cases cited therein.

Similarly, in considering the general tax status of Indians, the Supreme Court of the United States in its decision in *Squire* v. *Capoeman,* cited and discussed below, stated: "We agree with the Government that Indians are citizens and that in ordinary affairs of life, not governed by treaties or remedial legislation, they are subject to the payment of income taxes as are other citizens."

II. *Basic Categories of Income.*

Two basic categories of income are not subject to Federal income tax, to wit, where a treaty, agreement or act of Congress expressly provides that income is not subject to tax, and where income is derived directly from restricted allotted land held under circumstances discussed below.

The issue in *Squire* v. *Capoeman,* 351 U.S. 1 (1956), Ct. D. 1796, Cumulative Bulletin 1956-1, 605, was whether the gain from the sale of timber from restricted allotted lands, held in trust for a noncompetent Indian under the General Allotment Act of 1887, 24 Stat. 388, 25 U.S.C. 331 et seq., was subject to Federal income tax. The General Allotment Act had begun a new era in Federal Indian policy whereby tribal lands were to be divided and allotted to members of the tribe. The allotments were to be held in trust by the Government for 25 years or longer if the President deemed an extension desirable and then transferred to the allottee discharged of Government trusteeship "free of all charge or encumbrance whatsoever." The purpose of the act was to protect the Indians' interest and to prepare the Indians to take their place as independent qualified members of the modern body politic.

Section 6 of the act included a proviso authorizing the Secretary of the Interior to issue a patent in fee simple to any allottee competent of managing his own affairs, "and thereafter all restrictions as to sale, encumbrance, or taxation of said land shall be removed and said land shall not be liable to the satisfaction of any debt contracted prior to the issuing of such patent * * *" 25 U.S.C. 349. The Court concluded that the literal language of the proviso evinces a congressional

intent to subject an allotment to all taxes only after a patent in fee is issued, and implies that until the patent is issued, the allotment is to be free from all present and future taxes.

In holding that the income in question was not subject to Federal income tax, the Court concluded that to deny exemption would thwart the congressional intent manifested in the Allotment Act of not subjecting to the burdens of taxation proceeds from the allotment until the Indian had been emancipated and had received his title in fee for the land.

It is thus the position of the Service that income derived directly by a noncompetent Indian from allotted and restricted land held under the General Allotment Act or derived directly from land held under acts or treaties containing an exception provision similar to the General Allotment Act is not subject to the Federal income tax. See Revenue Ruling 59-349, Cumulative Bulletin 1959-2, 16, and Revenue Ruling 63-244, Cumulative Bulletin 1963-2, 21.

The Service will therefore recognize the exempt status of income received by an enrolled member of an Indian tribe where each of the following tests are met: (1) The land in question is held in trust by the United States Government; (2) such land is restricted and allotted and is held for an individual noncompetent Indian, and not for a tribe; (3) the income is "derived directly" from the land; (4) the statute, treaty or other authority involved evinces congressional intent that the allotment be used as a means of protecting the Indian until such time as he becomes competent; and (5) the authority in question contains language indicating clear congressional intent that the land, until conveyed in fee simple to the allottee, is 57 not to be subject to taxation. If one or more of these five tests is not met, and if the income is not otherwise exempt by law, it is subject to Federal income taxation.

## III. *Exempt Income - Restricted Allotted Land.*

Income held by the Court in *Capoeman* to be exempt from tax was categorized as income "derived directly" from the allotted and restricted lands. In Revenue Ruling 56-342, Cumulative Bulletin 1956-2, 20, as amplified by Revenue Ruling 62-16, Cumulative Bulletin 1962- , 7, this holding was interpreted to mean that income exempt under the *Capoeman* decision includes: rentals (including crop rentals), royalties, proceeds from the sale of the natural resources of the land, income from the sale of crops grown upon the land and from the use of the land for grazing purposes, and income from the sale or exchange of cattle or other livestock raised on the land. Proceeds from the sale of restricted allotted land while the fee title is still held by the Government in trust for the Indian are also exempt from tax. Revenue Ruling 57-407, Cumulative Bulletin 1957-2, 45.

Income derived from reinvesting income which is exempt under the five tests set forth in section II above is not exempt. To be exempt, income must be directly derived or attributable to the use or exploitation of the allotted land. See *Superintendent of Five Civilized Tribes* v. *Commissioner,* 295 U.S. 418 (1935), Ct. D. 974, Cumulative Bulletin XIV-1, 158 (1935). Income from a trust allotment rented from another Indian is not exempt. Revenue Ruling 57-523, Cumulative Bulletin 1957-2, 51.

## IV. *Transfer of Restricted Allotted Land.*

Income exempt under the five tests set forth in section II above remains exempt when the allotment is transferred to another noncompetent Indian by gift, devise or inheritance, even though the transferee may be of mixed Indian blood. See Revenue Ruling 57-523 and Revenue Ruling 62-16. Nor does the exemption cease when restricted allotted land is voluntarily

exchanged for restricted allotted land of like value, when such exchange is authorized by the Secretary of Interior.

In Revenue Ruling 62-16, it was held that unless otherwise provided by law, income from allotted land is not exempt where the Indian obtains his interest in the exempt land through an arm's length purchase. This position has been reconsidered in view of transactions by Indians regarded as unable to handle their own affairs to make intrafamily transfers of allotments or to assist needy Indians in acquiring small amounts of land where the purchase money consisted of restricted funds. The Service now concludes that income will ordinarily retain its exempt status when restricted allotted land is acquired for the above purposes by Deed Form 5-183b, unless the facts and circumstances clearly show the transfers were not made for such purposes. Revenue Ruling 62-16, Cumulative Bulletin 1962-1, 7, is modified to the extent inconsistent herewith.

Once an Indian has received a fee title to the land, the exempt status of income derived directly therefrom ends. See Revenue Ruling 58-341, Cumulative Bulletin 1958-2, 400, which discusses basis problems where the land is sold subsequent to being conveyed in fee simple to an Indian.

V. *Tax Status of Tribes; Tribal Income.*

Income tax statutes do not tax Indian tribes. The tribe is not a taxable entity. Tribal income not otherwise exempt from Federal income tax is includible in the gross income of the Indian tribal member when distributed or constructively received by him. See *Choteau* v. *Commissioner,* 283 U.S. 691 (1931), Ct. D. 352, Cumulative Bulletin X-1, 355 (1931). Amounts paid to tribal council members or officers are subject to income tax. Revenue Ruling 59-354, Cumulative Bulletin 1959-2, 24; *Commissioner* v. *Walker,* 326 F. (2d) 261 (1964).

Absent a provision in a treaty or statute to the contrary, income directly derived by a member of an Indian tribe from unallotted Indian tribal lands is subject to Federal income tax. Revenue Ruling 58-320, Cumulative Bulletin 1958-1, 24; *Bentley L. Holt,* 44 T.C. 686 (1965), affirmed 364 F. (2d) 38 (1966), certiorari denied, 386 U.S. 931 (1967)op of Form 2

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## Revenue Ruling 69-289

Section 61 – Gross Income Defined
1969-1, C.B. 34

Payments made to noncompetent Indians under programs administered by the Department of Agriculture's Stabilization and Conservation Service are income "derived directly from the land" and are excludable from gross income.

Advice has been requested whether payments made to noncompetent Indians under certain programs administered by the Agricultural Stabilization and Conservation Service of the United States Department of Agriculture are excludable from their gross incomes. The payments are made under programs having as their general objectives the conservation of soil and water resources, the maintenance of reasonable and stable supplies of agricultural commodities, and the protection of farm income. Payments are made to farmers for carrying out approved conservation practices, for diverting acreage from the production of crops, and in support of the prices for the crops they do produce. The programs under which the payments are made are: Agricultural Conservation

Program (16 U.S.C. 590h(b)); Appalachian Land Stabilization and Conservation Program (40 U.S.C. App. 203); Cropland Adjustment Program (7 U.S.C. 1838); Cropland Conversion Program (16 U.S.C. 590p(e)); Conservation Reserve Program (7 U.S.C. 1831); Feed Grain Program (16 U.S.C. 590p(i), 7 U.S.C. 1441 note); Wheat Program (7 U.S.C. 1339, 1379c); Upland Cotton Program (7 U.S.C. 1444(d)); Wool and Mohair Program (7 U.S.C. 1782, 1783); and Sugar Program (7 U.S.C. 1131).

The payments in question are those made in connection with allotted and restricted lands held in trust by the United States, as trustee for the noncompetent Indians, under the General Allotment Act of 1887, 24 Stat. 388, 25 U.S.C. 331 et seq.

Revenue Ruling 67-284, C.B. 1967-2, 55, provides general principles applicable to the Federal income tax treatment of income received by Indians. Section II of the Revenue Ruling sets forth five tests that must be met for such income to be excludable: (1) the land in question must be held in trust by the United States Government; (2) such land must be restricted and allotted and held for an individual noncompetent Indian; (3) the income must be derived directly from the land; (4) the statute, treaty or other authority involved must evidence congressional intent that the allotment be used as a means of protecting the Indian until such time as he becomes competent; and (5) the authority in question must contain language indicating clear congressional intent that the land, until conveyed in fee simple to the allottee, is not to be subject to taxation.

The question to be resolved in the instant case is whether the payments are “derived directly from the land” as that term is used in Revenue Ruling 67-284. Payments “derived directly from the land” include such items as rentals (including crop rentals), royalties, proceeds from the sale of natural resources on the land and from the sale of cattle and other livestock raised on the land, and income from the sale of crops grown on the land or from the use of the land for grazing purposes, Revenue Ruling 56-342, C.B. 1956-2, 20, as amplified by Revenue Ruling 62-16, C.B. 1962-1, 7.

Under the programs administered in the instant case, the payments are made to the noncompetent Indians for agreeing to use the land in certain ways, and for agreeing not to use the land in certain ways. Therefore, these payments are considered to be income “derived directly from the land” to the same extent as would be rentals of the land, or the proceeds of sale of crops grown on the land, and are excludable from the Indians’ gross income for Federal income tax purposes.

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## Revenue Ruling 74-13

1974-1 Cumulative Bulletin 14;
January, 1974
Section 61. - Gross Income Defined

The Internal Revenue Service will follow the decision in Stevens that income derived directly from restricted land purchased by the Secretary of the Interior on behalf of individual Indians and held in trust by the U.S. solely for their benefit under statutes construed to provide tax exemption for Indian property is exempt from Federal income tax regardless of source of the funds used to purchase the land; Revenue Rulings. 62-16 and 67-284 modified.

The Internal Revenue Service will follow the holding in *Stevens v. Commissioner,* 452 F.2d 741 (9th Cir. 1971), that income derived directly from restricted land purchased by the Secretary of the Interior on behalf of individual Indians under section 5 of the Indian Reorganization Act of 1934, 48 Stat. 985, 25 U.S.C. section 465 (1970), and held in trust by the United States solely for the benefit of such individual Indians under statutes that have been construed to provide tax exemption for Indian property, such as the General Allotment Act of 1887, 24 Stat. 388, 25 U.S.C. section 331 et seq., (1970), is exempt from the Federal income tax regardless of the source of the funds used to purchase the land.

Revenue Ruling 62-16, 1962-1 Cumulative Bulletin 7, held, in effect, that the exemption described above is not applicable where the Indian obtained his interest in the land through an arm's length purchase. This position was reconsidered in Revenue Ruling 67-284**,** 1967-2 Cumulative Bulletin 55, in view of transactions by noncompetent Indians to make intrafamily transfers of allotments or to assist needy Indians in acquiring small amounts of land with restricted funds. Revenue Ruling 67-284 holds that income will retain its exempt status where restriced allotted land is acquired for the above purposes by Deed Form 5-183b, thereby modifying Revenue Ruling 62-16.

Revenue Ruling 62-16 and Revenue Ruling 67-284 are modified to eliminate the holdings that income derived directly from purchased allotted land held in trust by the United States for the benefit of the Indians is not exempt from income tax.

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