BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 98R-0910
Samuel L. Flores	)	Case No. 89002462360
	)	

Representing the Parties:

For Appellant:	Christopher W. Hess, CPA
For Respondent:	Richard Gould, Tax Counsel
Counsel for Board of Equalization:	John S. Butterfield, Tax Counsel

O P I N I O N

This appeal is made pursuant to section 19324, subdivision (a),[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Samuel L. Flores for refund of personal income tax in the amount of $2,960 for the year 1996.

Appellant is an enrolled member of the Morongo Band of Mission Indians, hereinafter referred to as the "tribe." The Morongo Band is a federally recognized Indian tribe, which occupies a reservation in Riverside County, California. Appellant, however, is a resident of Walla Walla, Washington. The tribe operates a gaming facility on its reservation lands, which enterprise is a major source of employment for reservation members, and the predominant, if not exclusive source of income for the tribe. (See California v. Cabazon Band of Indians (1987) 480 U.S. 202 at 205.)

Under the terms of the Indian Gaming Regulatory Act, 25 United States Code sections 2701 et seq. ("IGRA"), the tribe is limited in the uses to which it may put profits derived from gaming conducted on its

[1]Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

reservation. The only purposes for which gaming revenues may be used are: "(i) to fund tribal government operations or programs; (ii) to provide for the general welfare of the Indian tribe and its members; (iii) to promote tribal economic development; (iv) to donate to charitable organizations; or (v) to help fund operations of local government agencies…" (25 U.S.C. § 2710(b)(2)(B), internal paragraphing omitted.) However, it appears that IGRA permits per capita payments to members of a tribe.[2] Tribes making such distributions are required to notify members that such per capita payments are subject to federal tax. (25 U.S.C. § 2710(b)(3)(D).) Tribes are also required to withhold federal tax from such payments. (Int.Rev. Code, § 3402(r).)

Apparently, the tribe issued 1099's to members receiving the per capita payments, and a copy of the 1099 for appellant was obtained by respondent. Respondent therefore dispatched a demand to appellant to file a non-resident tax return and report the per capita payment. Appellant filed the requested form and paid California tax on the amount of the payment. Appellant then filed a claim for refund, asserting that the payment to him was not subject to California tax. From a denial of the claim for refund, this appeal followed.

Non-residents of California are subject to tax in this state only upon income which is "derived from sources in this state." (Rev. & Tax. Code, §§ 17041 and 17951.) Appellant initially contended that the income from a source on the tribe's reservation was not from a source "in this state," because the reservation was "a separate sovereign nation" which, although surrounded by California, is not in California. We believe this assertion is incorrect. California has jurisdiction, for certain purposes, over persons residing on reservations, including tribal members, and causes of action arising on the reservation. (See, e.g., 28 U.S.C. § 1360(a)-certain states, including California, have civil jurisdiction over civil causes of action arising in Indian country to which Indians are parties.) If the reservation were not in California, no basis for jurisdiction of California courts, however limited, would exist. Prior California case law has rejected the contention that reservation lands do not form a part of the State of California, absent a document which expressly excepts it from the State. (Palm Springs Spa, Inc. v. County of Riverside (1971) 18 Cal.App.3d 371, 376.)

In support of its denial of the claim for refund, respondent points to its Regulation 17951-1 (Ca. Code Regs., tit. 18, § 17951-1.) Subdivision (b) of that regulation defines California-source income as including the distributive share of a non-resident member of a partnership, to the extent the partner's distributive share is derived from sources within California. Respondent asserts that the tribe should be regarded as a partnership, therefore making the distributions by the tribe of its California source gaming income to appellant taxable by this state. Respondent relies on the definition of "partnership" contained in Revenue and Taxation Code section 17008, which states that the term partnership includes "a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this part, a trust or estate or a corporation."

Appellant contends that the tribe more closely resembles a corporation. Distributions from a corporation are normally regarded as sourced to the domicile of the distributee. (Christman v. Franchise Tax Board (1976) 64 Cal.App.3d 751.) Revenue and Taxation Code section 17009 defines a corporation as including unincorporated associations "or other business entities taxable as a corporation under regulations of the Franchise Tax Board…" Respondent's regulation 23038, subdivision (b)(1)(B), provides that when an organization which has "associates" (i.e., it is not a sole proprietorship) and an objective to carry on a business, then "the determination of whether an organization which has such characteristics is to be treated for tax purposes as a partnership or as an association depends on whether there exists centralization of management, continuity of life, free transferability of interests, and limited liability." (Cal. Code Regs., tit. 18, § 23038, subd. (b)(1)(B).) The determination will be

[2] Presumably under the auspices of providing for the general welfare of the members of the tribe, as permitted under 25 U.S.C. § 2710(b)(2)(B)(ii).

made on the basis of whether the organization in question has more corporate characteristics than noncorporate characteristics. (Cal. Code Regs., tit. 18, § 23038, subd. (b)(1)(C).)

In this case, we believe appellant has the better of the argument. The tribe clearly has continuity of life, and respondent does not dispute that. Respondent similarly does not seriously dispute that the tribe, through its tribal government, has centralized management. Appellant, on the other hand, does not dispute that his tribal membership is not freely transferable. The major area of dispute is whether limited liability exists. Although respondent cites authority for the proposition that members of an unincorporated association may be held liable for the debts incurred by the association, we believe that is not the case for members of an Indian tribe.

For over two hundred years, Indian tribes in this country have enjoyed limited sovereign immunity. This immunity is rooted in the unique relationship between the United States government and the Indian tribes, whose sovereignty substantially predates the United States Constitution. (United States v. Oregon (9th Cir. 1981) 657 F2d 1009, 1013.) Certainly, no other right has been more zealously guarded or more highly prized by Indian tribes than their sovereignty. That sovereignty provides tribes with immunity from an unconsented suit. (Santa Clara Pueblo v. Martinez (1978) 436 U.S. 49, 58.) Yet, in defense of its position that tribal members do not have limited liability from claims against the tribe for breach of contract or torts, respondent would have us find that sovereign immunity could be eviscerated by the expedient of simply suing individual tribal members on such claims. We disagree. "An Indian tribe has a specific legal identity as a unique governmental entity; it is a domestic nation, a distinct political community that exercises powers of independence and self-government." (Chemehuevi Ind. Tribe v. California State Board of Equalization (9th Cir. 1985) 757 F.2d 1047, 1055.) Individual members have no more individual liability for the contracts or torts of the tribe than citizens of California have individual liability for the acts of this state's government. We find, therefore, that the characteristic of limited liability is present.

Given that the weight of factors favor regarding the tribe as an association taxable as a corporation, [3] we believe that payments from the tribe to its members, which payments are not compensation for services, must be regarded as income from an intangible sourced to the residence of the tribal member. Therefore, in appellant's case the payment will be regarded as not being California source income, but rather having a source at appellant's residence in the state of Washington. As such, appellant is not subject to California tax on the income.[4]

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[3] The U.S. Supreme court has held that federal preemption prohibits state taxation of Indian tribes or lands. (See Bryan v. Itasca County (1976) 426 U.S. 373, 376-377.) Thus, but for such preemption, the tribe would be subject to tax and, under respondent's regulation, it appears that it would be taxable as an association.

[4] We note that if the payment was received by a tribal member residing in California but not on the reservation, it is taxable by California since the recipient is a resident. The source of the payment from the reservation does not exempt it from tax. (Leahy v. State Treasurer of Oklahoma (1936) 297 U.S. 420.) However, if the payment were received by a tribal member residing on the reservation, even if the reservation is in California and the member therefore a resident of California, the payment would not be taxable. (McClanahan v. Arizona State Tax Commission (1972) 411 U.S. 164; Oklahoma Tax Com. v. Sac & Fox Nation (1993) 508 U.S. 114.)

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19333 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Samuel L. Flores for refund of personal income tax in the amounts of $2,960 for the year 1996 be and the same is hereby reversed.

Done at Sacramento, California, this 21st day of June, 2001, by the State Board of Equalization, with Board Members Mr. Andal, Mr. Klehs, Mr. Chiang and Ms. Mandel* present, Mr. Parrish not participating.

_____, Chairman

Dean F. Andal, Member

John Chiang, Member

Johan Klehs, Member

_____, Member

flores jsb

*For Kathleen Connell per Government Code section 7.9.