



## Application of Michigan and Federal Taxes, Exemptions, and Policy to

# Tribal Members and Tribal Governments



By **Jill J. Babcock** and **Daniel S. Hoops**

**T**he U.S. Bureau of Indian Affairs (BIA) recognizes 565 Native American tribes and Alaska Natives.<sup>1</sup> Although tribal members are U.S. citizens and reside within the United States, a tribe must seek recognition as a tribe by the U.S. Department of Interior or congressional action to qualify as a sovereign nation by the BIA.<sup>2</sup> A tribe located in Michigan inevitably has an effect on state taxation and revenue policies.

Like most states, Michigan reconciles its service provisions and revenues with tribes and tribal members through tax agreements (or treaties) called voluntary disclosure agreements (VDAs). The VDA provides a rational standard to apply relevant taxes to the tribe, the method in which the tax is collected, and dispute resolution procedure.<sup>3</sup> Under Michigan law, the state may enter into a VDA only with a recognized tribe<sup>4</sup> and the agreement is limited to those taxes set forth in the VDA.<sup>5</sup>

### Tribal Status

A common myth is that tribes and tribal members do not pay any state or federal taxes or that Indian nations are exempt from all tax. The authority to tax tribes and tribal members is a far more complex issue under U.S. law.

The first issue relates to the general tax benefits conferred upon tribes by Congress under the United States Constitution<sup>6</sup> and the United States Supreme Court's interpretation of Indian tribal status. Generally, states are unable to levy taxes on tribes or tribal members for activities on federally recognized tribal lands but can impose taxes on activities outside tribal lands.<sup>7</sup>

The second issue relates to defining tribal activities states are authorized to tax.<sup>8</sup>

## Federal Taxation

Without a specific congressional exemption, tribes are subject to federal taxes in the same manner as states, and states' residents are subject to federal tax.<sup>9</sup> The Supreme Court held that Indians are citizens and are liable for the payment of federal income taxes unless exempted by applicable treaties or remedial legislation.<sup>10</sup>

## State Taxation

Although states are restricted from assessing direct taxes on tribes and tribal members, the Supreme Court has upheld the rights of states to assess tax under some circumstances. A state tax on gross receipts of an off-reservation, tribe-owned ski resort was permitted in *Mescalero Apache Tribe v. Jones*.<sup>11</sup> A state income tax on tribal members who resided off their reservation but earned their income from the reservation was upheld in *Oklahoma Tax Commission v. Chickasaw Nation*.<sup>12</sup>

In *White Mountain Apache Tribe v. Bracker*,<sup>13</sup> the Supreme Court established a balancing test for state, federal, and tribal interests to determine what authority a state had over the conduct of non-tribal members doing business with tribal members.<sup>14</sup> The *Bracker* test applies only if a state asserts taxing authority over the conduct of non-tribal members engaged in an activity on tribal lands.<sup>15</sup> Other Supreme Court decisions applying the *Bracker* test provide additional guidance for states contemplating changes to their tax policy.<sup>16</sup>

## Michigan Property Taxes

There are three categories of tribal lands under federal law: reservations, dependent Indian communities (whether subsequently acquired or deemed an original territory), and Indian allotments whose titles have not been extinguished.<sup>17</sup> The General Property Tax Act (GPTA)<sup>18</sup> does not distinguish between these categories of tribal lands because sovereign real property is exempt from tax.<sup>19</sup> A tribe's personal property, however, can be taxed under

the GPTA unless it meets the requirements for an exemption. An exemption from property tax is allowed if negotiated in a VDA between the tribe and state, and the property is used exclusively within the tribe's lands.<sup>20</sup>

Real property exemptions exist under the GPTA for tribal members whose real property is situated on designated tribal land. Personal property owned by a tribal member is subject to the state's *ad valorem* tax but can be exempt if (1) the tribal member purchased the property and used it exclusively within the tribal lands and (2) there is a specific tax agreement between the member's tribe and the state.<sup>21</sup>

Exemptions under the GPTA are otherwise unavailable for members of non-federally recognized tribes, tribal members whose use of property is not exclusively on tribal lands, or non-tribal member property owners whose property is used exclusively on tribal lands.

## Michigan Business Tax

A business tax (i.e., a levy on business activities) can come in many different forms under state law. The state of Michigan has the Michigan Corporate Income Tax (CIT), which is a corporate flat tax based on business income.<sup>22</sup>

Tribes and tribal members do not have an exemption from the CIT. The closest the CIT statute comes to exempting sovereigns is to exempt "foreign people." However, the statute defines "foreign person" as "a person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the internal revenue code."<sup>23</sup>

Tribes and tribal members are clearly omitted from the definition of foreign person. Nevertheless, the income from businesses owned by tribes or tribal members (in the circumstances described below) is essentially exempt from state taxation under federal preemption.<sup>24</sup>

Businesses owned by tribal members covered by a VDA are granted the same rights under the VDA as their tribe. If federal law provides that the CIT is applicable to a particular business,<sup>25</sup> the VDA must be analyzed to determine the relationship of the tribal member and the state.

Businesses owned by non-tribal members within tribal lands are not exempt from the CIT, regardless of whether there is a VDA with the state and the tribe.

## Michigan Income Tax

If a tribe generates revenue attributable to a wholly or partially owned enterprise doing business on or off the tribe's land (or an area designated in a VDA), the revenue will be subject to apportionment with the income generated solely on tribal land being exempt from the Income Tax Act.<sup>26</sup> There are some circumstances in which an income tax can be assessed against the tribe itself, including when the tribe is not a recognized sovereignty by the state or federal governments.<sup>27</sup>

### Fast Facts:

Michigan reconciles its service provisions and revenues with tribes and tribal members through tax agreements (or treaties) called voluntary disclosure agreements.

Generally, states are unable to levy taxes on tribes or tribal members for activities on federally recognized tribal lands but can impose taxes on activities outside tribal lands.

There are some circumstances in which an income tax can be assessed against a tribe itself, including when the tribe is not a recognized sovereignty by the state or federal governments.



In addition to tribes, Michigan is prohibited from imposing a tax on the income of tribal members if the income is sourced to tribal land or within a VDA-covered area.<sup>28</sup> The Michigan Department of Treasury issued a revenue bulletin providing that Michigan income tax:

- can be imposed on Indians if sourced outside the reservation,
- applies to non-Indians if sourced on the reservation, and
- cannot be imposed on Indians if sourced on the reservation.<sup>29</sup>

Michigan defines taxable income as the “adjusted gross income” defined in the Internal Revenue Code of 1986 (the Code).<sup>30</sup> Federal caselaw should be read in conjunction with section 62 of the Code to determine *if* items of income may be excluded from the income tax for tribes and tribal members.

### Michigan Sales and Use Tax

Michigan defines the sales tax as a fee “paid to the state for the privilege of engaging in certain business activities.”<sup>31</sup> Most commercial businesses in Michigan transfer this liability to the consumer and charge an additional amount on each purchase to offset the cost of this tax. A use tax is a “levy, assessment, and collection of a specific excise tax on the storage, use, or consumption in this state of tangible personal property and certain services.”<sup>32</sup> The use tax is a self-reported assessment and reported on an individual’s state income tax return because out-of-state commercial businesses are not required to withhold taxes.

While the state struggles with its tax policies and budget shortages, understanding the principles of *how* tribes and tribal members can be taxed is important to reduce confusion and increase clarity on the state’s overall tax policy.

Tribes and tribal members are exempted from Michigan sales and use taxes as long as purchased items are covered by a VDA.<sup>33</sup> If an item is not specifically listed on a VDA, a tribal member may request a tribal certificate of exemption and a letter of authorization from the Michigan Department of Treasury. Tribal members may also seek a refund for sales or use taxes paid on certain eligible purchases. In addition, if a tribe is not a party to a VDA with the state, some purchased items could be considered exempt from sales or use taxes under federal law.<sup>34</sup> Some items are specifically excluded from VDAs and not exempt under federal law. For example, the sale of cigarettes and motor fuels involving tribes and tribal members are both subject to Michigan sales and use taxes.

The Michigan Department of Treasury created Forms 4765 and 4766 for tribes and tribal members to verify their exemptions from sales and use taxes.

## Conclusion

The taxation of tribes and tribal members is an interesting policy issue. Its complexity leads to misunderstandings and untruths. While the state struggles with its tax policies and budget shortages, understanding the principles of *how* tribes and tribal members can be taxed is important to reduce confusion and increase clarity on the state's overall tax policy. ■

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## FOOTNOTES

1. US Dep't of the Interior, *Indian Affairs* <<http://www.bia.gov/WhoWeAre/index.htm>>. All websites cited in this article were accessed June 10, 2012. The following tribes located in Michigan enjoy sovereign status: (1) Bay Mills Indian Community, (2) Hannahville Indian Community, (3) Grand Traverse Band of Ottawa and Chippewa Indians, (4) Little River Band of Ottawa Indians, (5) Little Traverse Bay Bands of Odawa Indians, (6) Match-E-Be-Nash-She-Wish Band of Potawatomi Indians, (7) Nottawaseppi Huron Band of Chippewa Indians, (8) Pokagon Band of Potawatomi Indians, (9) Sault Ste. Marie Tribe of Chippewa Indians, (10) Keweenaw Bay Indian Community, (11) Lac Vieux Desert Band of Lake Superior Chippewa Indians, and (12) Saginaw Chippewa Indian Tribe.
2. 26 USC 7871; *McClanahan v Arizona Tax Comm*, 411 US 164; 93 S Ct 1257; 36 L Ed 2d 129 (1973); see also *Oklahoma Tax Comm v Sac and Fox Nation*, 508 US 114; 113 S Ct 1985; 124 L Ed 2d 30 (1993) (the state has no role to play in any matters involving a tribe on tribal land and is therefore completely sovereign from state law).
3. Current state voluntary disclosure agreements exist between the state of Michigan and nine federally recognized tribes. See Bay Mills Indian Community, Grand Traverse Band of Ottawa and Chippewa Indians, Hannahville Indian Community, Little River Band of Ottawa Indians, Little Traverse Bay Bands of Odawa Indians, Match-E-Be-Nash-She-Wish Band of Potawatomi Indians, Nottawaseppi Huron Band of Chippewa Indians, Pokagon Band of Potawatomi Indians, Saginaw Chippewa Indian Tribe, and Sault Ste. Marie Tribe of Chippewa Indians <[http://www.mi.gov/taxes/0,1607,7-238-43513\\_43517--,00.html](http://www.mi.gov/taxes/0,1607,7-238-43513_43517--,00.html)>.
4. In addition to the 12 federally recognized sovereign tribes, the Burt Lake Band of Ottawa and Chippewa Indians, Grand River Bands of Ottawa Indians, Gun Lake Band of Grand River Ottawa Indians, and Swan Creek Black River Confederated Ojibwa Tribes are recognized by the state of Michigan but not the BIA. The Burt Lake Band of Ottawa and Chippewa Indians, Consolidated Bahwetig Ojibwas and Mackinac Tribe, Genesee Valley Indian Association, Grand River Bands of Ottawa Indians (formerly Grand River Band Ottawa Council), Gun Lake Village Band of Potawatomi Indians, Lake Superior Chippewa of Marquette, Little Owl Band of Central Michigan Indians, Mackinac Bands of Chippewa and Ottawa Indians, Maconce Village Band of Ojibwa, Maple River Band of Ottawa, Muskegon River Band of Ottawa Indians, Ooragnak Indian Nation, Ottawa Colony Band of Grand River Ottawa Indians, Potawatomi Indians of Indiana and Michigan, Swan Creek Black River Confederated Ojibwa Tribes, The Chi-cau-gon Band of Lake Superior Chippewa of Iron County, and Wyandot of Anderdon Nation have petitioned the BIA for federal recognition. See <[http://www.aanativearts.com/tribes-by-states/michigan\\_tribes.htm](http://www.aanativearts.com/tribes-by-states/michigan_tribes.htm)>.
5. MCL 205.30c(12).
6. US Const, art I, § 8.
7. See *United States v Mazurie*, 419 US 544, 557; 95 S Ct 710; 42 L Ed 2d 706 (1975).
8. *Oklahoma Tax Comm v Chickasaw Nation*, 515 US 450; 115 S Ct 2214; 132 L Ed 2d 400 (1995).
9. 26 USC 7871(a)(1); see 26 USC 7871(e) (tribes are exempt from federal tax for any activity that would be considered a taxable activity, unless such activity is considered an "essential governmental function" customarily performed by state and local governments with general taxing power).
10. *Squire v Capoean*, 351 US 1, 6; 76 S Ct 611; 100 L Ed 883 (1956); see also *Estate of Shelton v Comm'r*, 68 TC 15 (1977) (treatment of income and deductions in respect of a decedent); *Doxlator v Comm'r*, 89 TCM 1259 (2005) (discussing income and self-employment tax).
11. *Mescalero Apache Tribe v Jones*, 411 US 145; 93 S Ct 1267; 36 L Ed 2d 114 (1973).
12. *Oklahoma Tax Comm*, 515 US at 462–467.
13. *White Mountain Apache Tribe v Bracker*, 448 US 136; 100 S Ct 2578; 65 L Ed 2d 665 (1980).
14. *Id.*
15. *Wagon v Prairie Band Potawatomi Nation*, 546 US 95; 126 S Ct 676; 163 L Ed 2d 429 (2005) (involving a motor carrier license fee and use fuel taxes imposed on on-reservation logging and hauling operations by non-Indian contractor); see *California v Cabazon Band of Mission Indians*, 480 US 202; 107 S Ct 1083; 94 L Ed 2d 244 (1987) (prohibiting the state from regulating non-Indian customers of tribal bingo operation); *New Mexico v Mescalero Apache Tribe*, 462 US 324; 103 S Ct 2378; 76 L Ed 2d 611 (1983) (barring the state from enforcing its gaming laws against non-Indians for on-reservation hunting and fishing).
16. *Dept of Taxation and Finance v Milhelm Attea & Bros, Inc*, 512 US 61; 114 S Ct 2028; 129 L Ed 2d 52 (1994) (various taxes imposed on non-Indian purchasers of goods retailed on-reservation); *Cotton Petroleum Corp v New Mexico*, 490 US 163; 109 S Ct 1698; 104 L Ed 2d 209 (1989) (imposing state severance tax on non-Indian lessee's on-reservation production of oil and gas).
17. 18 USC 1151.
18. MCL 211.1 *et seq.*
19. 26 USC 7871; *McClanahan v Arizona Tax Comm*, 411 US 164; 93 S Ct 1257; 36 L Ed 2d 129 (1973); see also *Keweenaw Bay Indian Community v Natfaly*, 452 F3d 514 (CA 6, 2006).
20. MCL 205.30c(12)(c)(i).
21. See *Keweenaw*, 452 F3d at 525–527; MCL 205.30c.
22. MCL 206.1 *et seq.*
23. MCL 2.06.625.
24. In *McClanahan*, 411 US at 168, the court held that a state cannot impose a tax on the income of a tribal member or a business owned by that tribal member if (1) the tribal member belongs to a federally recognized tribal entity, (2) the tribal member resides on a reservation of that tribal entity, and (3) the tribal member's income is derived and sourced from that reservation.
25. 26 USC 7871.
26. *McClanahan*, 411 US at 168; see Dep't of Treasury, *Michigan Taxes* <[http://www.michigan.gov/taxes/0,1607,7-238-43513\\_43517--,00.html](http://www.michigan.gov/taxes/0,1607,7-238-43513_43517--,00.html)> (10/8/2011).
27. Johnson, *et al.*, *Models of Cooperation Between States and Tribes* (Washington, DC: Nat'l Conference of State Legislatures, 2009), available at <<http://www.nijc.org/pdfs/TTAP/NCSIGovtoGovt.pdf>>.
28. *McClanahan*, 411 US at 168.
29. RAB 1988-47, available at <[http://www.michigan.gov/treasury/0,1607,7-121-44402\\_44415\\_44416-7363--,00.html](http://www.michigan.gov/treasury/0,1607,7-121-44402_44415_44416-7363--,00.html)>.
30. MCL 206.30(1); 26 USC 62.
31. Preamble, MCL 205.51 through 205.78; 1933 PA 167.
32. Preamble, MCL 205.91 through 205.111; 1937 PA 94.
33. MCL 205.30c(12)(c)(i).
34. These are usually exempted by treaty. See Nat'l Congress of American Indians, *The Nat'l Congress of American Indians Resolution #MKE-11-1011*, available at <[http://www.ncai.org/attachments/Resolution\\_AwZwFjnEUSyGtGzueiPLRxtRmYpKZdAQsrHlgRTkjtbyaCNA\\_MKE-11-011\\_final.pdf](http://www.ncai.org/attachments/Resolution_AwZwFjnEUSyGtGzueiPLRxtRmYpKZdAQsrHlgRTkjtbyaCNA_MKE-11-011_final.pdf)>.