

INITIAL DISCUSSION PAPER

Approach to Determining Whether a Tribal Member is "Living On" or "Living Off" His or Her Tribe's Reservation for California Personal Income Tax Purposes.

Issues

Questions have arisen as to when an individual who is an enrolled member of a federally recognized Indian tribe (hereinafter "Tribal Member") is considered "living on" or "living off" his or her own tribe's reservation for purposes of the California personal income tax.¹ This discussion paper will address the following two issues:

1. When will a Tribal Member be treated as "living on" or "living off" his or her own tribe's reservation for purposes of imposing the California personal income tax if the Tribal Member has been "granted the right to occupy"² a dwelling located on the tribe's reservation and owns, rent or leases a second dwelling located off the tribe's reservation?
2. If a Tribal Member is "living on" his or her tribe's reservation, when should a temporary absence alter this status?

Furthermore, the Franchise Tax Board ("FTB") seeks additional input related to the following issues:

1. What documentation and evidence is sufficient to establish that a Tribal Member has the right to occupy a specific dwelling?
2. If a Tribal Member has the right to occupy two or more dwellings, what kind of documentation and evidence will be considered in order to determine the dwelling with which the Tribal Member has maintained his or her "closest connections"?

¹ The United States Supreme Court has used the terms "living on" and "residing on" synonymously (*Oklahoma Tax Commission v. Sac and Fox Nation* (1993) 508 US 114, 123); as "living on" is used in most FTB publications, including FTB 674 (Rev. 04-2010), "living on" will be used throughout this discussion paper.

² For purposes of this discussion paper, the term "granted the right to occupy," recognizes that in many circumstances a Tribal Member is prevented from owning, renting or leasing property on his or her reservation, yet has been granted possession akin to the same. Furthermore, "granted the right to occupy" means more than being an invited guest of another person or occupying transient accommodations, as defined by Cal. Civil Code § 1940. "Granted the right to occupy" infers a legitimate property right held by a Tribal Member.

Background

The general rule is that a Tribal Member residing within the geographical boundaries of California is a California resident³ and is subject to California personal income taxes on his or her entire taxable income.⁴ However, under *McClanahan v. Arizona State Tax Commission* (1974) 411 U.S. 164, a Tribal Member who is "living on" his or her own tribe's reservation, is exempt from paying a state's personal income taxes on income earned from sources within the boundaries of his or her own tribe's reservation.⁵

However, neither the Courts nor the legislature has provided meaningful guidance as to how the FTB should determine whether a Tribal Member is "living on" his or her own reservation. This inquiry is further complicated when a Tribal Member has the right to occupy a dwelling on his or her reservation and owns, rents or leases a second dwelling located off of his or her tribe's reservation (collectively referred to as "subject properties").

Application of the Closest Connection Test

The FTB will apply the "closest connections test" articulated in numerous Board of Equalization ("BOE") decisions, including the *Appeal of Stephen Bragg*, 2003-SBE-003 (May 28, 2003), to determine whether a Tribal Member is "living on" or "living off" his or her own tribe's reservation. Once it is determined that a Tribal Member is "living on" his or her own tribe's reservation, the Tribal Member will continue to be treated as "living on" his or her own tribe's reservation while "temporarily" absent from his or her tribe's reservation. This test, as applied to certain hypothetical facts, is attached to this discussion paper as Exhibit 1.

Discussion

Issue One: "Living on" the Reservation

Under *McClanahan*, a Tribal Member qualifies for an exemption from state personal income taxation when the three following conditions are satisfied:

- 1) The individual must be a Tribal Member of a federally recognized Indian tribe;

³ See *Nevada v. Hicks* (2001) 533 US 353, 361-362 (" . . . [I]t is now clear [that] an Indian reservation is considered part of the territory of the State"). Also, it is important to note that a Tribal Member who resides in California, whether or not he or she lives on a reservation is a California resident and must file a California Resident Tax Return on Form 540. If he or she has tribal income which is exempt from California tax that income should be excluded using Schedule CA.

⁴ Indians who are members of the Armed Forces are subject to special rules under Cal. Rev. & Tax. Code §17140.5, which provides that the military wages of a Tribal Member are exempt from California personal income tax when the income is compensation wages paid to an active member of the Armed Forces where the Tribal Member's residence was within his or her tribe's "Indian Country" at the time of entering service, and the Tribal Member has not elected to abandon such residence.

⁵ *McClanahan*, at 168, frames the issue as ". . . may [a State] tax a reservation Indian for income earned exclusively on the reservation."

- 2) The individual must live in his or her tribe's Indian country (which includes reservations, dependent Indian communities, and Indian trust allotments);⁶ and
- 3) The income must be from sources within the same Indian country where the taxpayer lives and where he or she is a tribal member.

However, as mentioned above, neither *McClanahan* nor its progeny consider whether or not a Tribal Member is living on his or her reservation when he or she has been granted the right to occupy a home located on his or her reservation and owns, leases or rents a home located off of his or her reservation. Further, there is no California statute or case that provides a test for determining in which of two or more California dwellings the Tribal Member resides. To resolve this question, as discussed above, the FTB will apply a "closest connections test." The factors relevant in determining a Tribal Member's closest connections, to the extent they are probative, will include, but will not be limited to, the following:

- Location of all residential property that the Tribal Member either owns or has been granted the right to occupy;
- Origination point of telephone calls made by the Tribal Member;
- Address used for correspondence with government agencies, financial institutions and the like;
- Utility usage, if applicable;
- Where a homeowners' exemption is claimed, if at all;
- Comfort level of the comparison homes; and
- Declarations as defined by section 116.130 of the California Code of Civil Procedure.

Under the "closest connections test," if it is determined that a Tribal Member's closest connections are with a dwelling or dwellings on his or her own tribe's reservation, he or she will be deemed to be "living on" his or her tribe's reservation. But if a Tribal Member's closest connections are with a dwelling located outside his or her own tribe's reservation, then he or she will be deemed to be "living off" the tribe's reservation. Where a Tribal Member is "living off" the tribe's reservation, all of the Tribal Member's income, including the income from sources on a reservation, will be subject to California personal income tax.

Issue Two: Temporary Absences

If a Tribal Member is determined to be "living on" his or her tribe's reservation, he or she will continue to be treated as "living on" his or her tribe's reservation even when temporarily absent from their tribe's reservation. However, if the Tribal Member leaves his or her tribal reservation for other than a temporary purpose, he or she thereupon ceases to be "living on" his or her reservation. Should a Tribal Member be determined to be "living off" his or her tribe's reservation, he or she will continue to be treated as "living off" his or her tribe's reservation as long as his or her presence on the tribe's reservation is for a temporary purpose. This treatment is consistent with the treatment of a California resident under California Code of Regulations, title 18, section 17014, subsection (a).

⁶ 18 U.S.C. §1151.

Furthermore, a Tribal Member's absence for a temporary purpose for any part of the taxable year would include, but would not be limited to, "passing through" land outside the tribe's reservation or an absence from the tribe's reservation for a brief rest, a vacation, or to complete a particular transaction, perform a particular contract, or perform a particular engagement. This treatment is consistent with the treatment of a California resident under California Code of Regulations, title 18, section 17014, subsection (b).

Recommendation

As discussed above, determining whether a Tribal Member is "living on" or "living off" of his or her tribe's reservation is essentially a two-part test. The first part of the test identifies the subject properties, if any, that a Tribal Member has the right to occupy. The second part of the test determines with which of the subject properties the Tribal Member maintained his or her closest connections.

The Franchise Tax Board suggests that the following documentation and evidence, subject to subsequent discussions and meetings, will be helpful in determining whether a Tribal Member has the right to occupy two or more dwellings during a specific taxable year:

- Letters and declarations from tribal leadership, property owners and their agents, and any other person who can demonstrate that a Tribal Member had the right to occupy a specific dwelling;
- Lease and rental agreements, titles to property; and
- Land sales agreements.

In addition, the Franchise Tax Board suggests that the following documentation and evidence, subject to subsequent discussions and meetings, will be helpful in determining with which subject property the Tribal Member maintains his or her closest connection:

- Records from telephone and other media providers that depict usage in a particular location;
- County records as to polling place and existence of home owner's exemption;
- Financial records depicting the Tribal Member's mailing address;
- The location of point of sale transactions as shown on cancelled checks, credit card and bank statements, and receipts;
- Computer print-outs evidencing a Tribal Member's entry into a secure location by key card;
- Utility bills that reflect usage in a particular dwelling;
- Records that reflect the amount of occupants to a specific dwelling; and
Records that reflect the approximate size of the dwelling and the amenities associated with the same.

It is important to note that the above lists are not exclusive, but are subject to change if documents and evidence, not discussed above, are likely to weigh in favor of a Tribal Member "living on" or "living off" his or her reservation.

Summary

The Franchise Tax Board will apply a "closest connections" test to determine whether the Tribal Member is "living on" or "living off" of his or her own tribe's reservation. Once it is determined that the Tribal Member is "living on" his or her own tribe's reservations, a temporary absence will not alter this determination.

Finally, the Franchise Tax Board suggests that certain documents and evidence will be helpful in determining whether a Tribal Member has the right to occupy a specific dwelling; and if so, with which of the subject properties the Tribal Member has maintained his closest connections. In addition to the documents identified above, the Franchise Tax Board seeks additional discussion in expanding or contracting these lists.