IN THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF OKLAHOMA

JOHN A. "ROCKY" BARRETT, JR., and SHERYL S. BARRETT,	)	
Plaintiffs,	)	
v.	)	Civil No. 5:06-cv-00968-HE
UNITED STATES OF AMERICA,	)	
Defendant.	)	

MEMORANDUM IN SUPPORT OF UNITED STATES' MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases:

Statutes:

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MEMORANDUM IN SUPPORT OF UNITED STATES' MOTION FOR SUMMARY JUDGMENT

The United States moves for summary judgment against the plaintiffs, John and Sheryl Barrett, on their claim for a refund for federal income taxes and penalties paid to the Internal Revenue Service for the year 2001. The United States seeks summary judgment because the income received by John Barrett in the year 2001 for duties performed for the Citizen Potowatomi Nation is taxable and not excluded from income by any statute or treaty. The United States incorporates the Joint Stipulation of Facts submitted on August 15, 2007. [Docket No. 28.]

I. INTRODUCTION

The Sixteenth Amendment generally authorizes Congress to tax income "from whatever source derived." U.S. Const. Art. II, Amend. XVI. The Internal Revenue Code further provides that "except as otherwise provided in this subtitle, gross income means all income from whatever source derived including (but not limited to) ... (1) compensation for services." 26 U.S.C. § 61(a). The plaintiffs seek to exempt from federal income tax the $48,057.64 plaintiff John Barrett ("Barrett") received in the year 2001 while working full-time in his position as Chairman of the Citizen Potawatomi Nation (the "Tribe").

In order to show that income received is not subject to income tax, the plaintiffs must show that Barrett's income is specifically exempted by law. The plaintiffs mistakenly rely on various federal statutes, none of which provide that Barrett's income is exempt from taxation.[1] Plaintiffs rely on a 1959 revenue ruling, which holds only that the Tribe is not liable for Federal Insurance Contributions Act (FICA) or Federal Unemployment Tax Act (FUTA) taxes for amounts paid to tribal council members. Rev. Rul. 59-354. Plaintiffs also erroneously rely on the Indian Tribal Judgment Funds Use or Distribution Act and a Potawatomi judgment fund disposition statute, which exempt from taxation only those amounts of trust funds distributed pro rata to members of Indian tribes. 25 U.S.C. § 1407 (1973); 25 U.S.C. § 881 (1970). Plaintiffs next mistakenly rely on an inapplicable version of the Internal Revenue Manual, I.R.M. § 4.88.1.6.3.1, which is superceded by the statutes to which it cites. Lastly, the plaintiffs rely on several other inapposite statutes and treaties in support of their claim.

II. LEGAL STANDARDS AND ARGUMENT

A moving party is entitled to summary judgment if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R.Civ. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). A genuine issue of material fact exists if a reasonable jury could return a verdict for the nonmoving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). In order to grant summary

[1] In their Complaint, the Barretts state that Barrett's income is "not taxable income based on the relevant statutes, legislative history, regulatory decisions, the settlement between the Citizen Potawatomi Nation and the Indians Claims Commission and/or treaties." (Docket No. 1 at ¶ 10.) In their administrative claim for refund, the Barretts cited several specific statutes and provisions they claim provide that Barrett's income is not taxable. *See* Ex. 3 at ¶ 5 and Ex. 4.

judgment, the Court must view the evidence in the list most favorable to the non-moving party to determine that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp*., 475 U.S. 574, 587 (1986); *Mansker v. TMG Life Ins. Co.*, 54 F.3d 1322, 1326 (8th Cir. 1995). Once the moving party establishes the absence of any factual issues for trial, the non-moving party must offer admissible evidence of specific facts showing that a genuine issue of material fact exists, or that the moving party is not entitled to judgment as a matter of law, in order to defeat summary judgment. Fed. R. Civ. P. 56(e); *Chism v. W.R. Grace & Co.*, 158 F.3d 988, 990 (8th Cir. 1998).

The federal courts have consistently held that income received by members of registered Indian tribes such as the Citizen Potowatomi Nation is subject to federal income tax. *See Squire v. Capoeman*, 351 U.S. 1, 6 (1956) ("We agree with the Government that Indians are citizens and that in the ordinary affairs of life, not governed by treaties or remedial legislation, they are subject to the payment of income taxes as are other citizens."). *See also Lafontaine v. Commissioner*, 533 F.2d 382 (8th Cir. 1976) (finding that none of the thirty statutes and treaties cited by the plaintiff exempted his income from taxation). Any exemption from federal income taxation "must derive plainly from [tribal agreements] ... or some Act of Congress," and an Indian claiming an exemption must point to "express exemptive language in some statute or treaty." *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 156 (1973) and *United States v. Anderson*, 625 F.2d 910, 917 (9th Cir. 1980). Specifically, income received as a tribal officer is taxable to the recipient. *See Commissioner v. Walker*, 326 F.2d 261 (9th Cir. 1964) (finding that amounts paid to tribal council members or officers are subject to income tax). During 2001, all of the income Barrett received was for his services carrying on the daily business of the Tribe.

A. Revenue Ruling 59-384 Does Not Exempt the Barretts' Income from Taxation.

Despite the clarity of the decisions holding income as taxable, the plaintiffs claim that Revenue Ruling 59-384 exempts Barrett's income from federal taxation. That ruling, issued in 1959, governs Indian tribes' liability for FICA and FUTA taxes, and provides as follows:

> Although includible in gross income under section 61 of the Internal Revenue Code of 1954, amounts paid to members of Indian tribal councils for services performed by them as council members do not constitute 'wages' for the purposes of the Federal Insurance Constributions Act, the Federal Unemployment Tax Act and the collection of income tax at source on wages.

Rev. Rul. 59-354 (1959). Internal Revenue Code §§ 3102, 3111, 3301, and 3402 generally require employers to withhold federal income and FICA taxes from their employees' wages, and to pay over those withholdings, along with the employer's own FICA and FUTA taxes, to the IRS. The revenue ruling only exempts recognized Indian tribes from the withholding requirements of the above-listed taxing provisions respecting payments made to tribal council members. In fact, the revenue ruling plainly supports the United States' position as it specifically provides that amounts paid to tribal council members are "includible in gross income under section 61 of the Internal Revenue Code of 1954." Rev. Rul. 59-354 (1959).

Nevertheless, plaintiffs ignore the revenue ruling's unequivocal statement that income received by tribal council members is subject to federal tax as well as subsequent case law upholding the taxability of such payments. For example, in *Walker*, the court considered whether the Treasurer of the Gila River Pima-Maricopa Indian Community was subject to income taxes for amounts received as Treasurer. 326 F.2d at 264. The court reversed the decision of the Tax Court in finding that the plaintiff had earned the income as an employee of the tribe and was liable for federal income taxes on the income. In so holding, the court

reasoned that "[i]f, under the law, the income of an organization is exempt from taxation, it does not follow that the income received by an employee as compensation for service rendered to such organization is also exempt from taxation." *Id.* at 263. The court further stated that it had found no statute or treaty exempting the plaintiff's income from federal income taxes. *Id.* at 263-64. Numerous federal courts have similarly held that a tribal council member must pay federal income taxes on wages earned from their respective tribes. *See e.g.*, *Allen v. Commissioner*, 2006 WL 177408 (T.C. 2006) ("A tribal official, whether elected or appointed, is subject to income tax on the compensation received for rendering services to the tribe unless a treaty or statute specifically provides an exemption."); *Hoptowit v. Commissioner*, 78 T.C. 137, 145-148, 1982 WL 11067 (1982); *Jourdain v. Commissioner*, 71 T.C. 980, 986-987, 1979 WL 3595 (1979); *Allen v. Commissioner*, T.C.M. (RIA) 2005-118, 2005 WL 1208509 (2005).

Case law teaches that income received by a tribal council member is not exempt merely because it is paid from trust funds. In *Hoptowit*, the plaintiff received his income from funds held in trust by the federal government for the benefit of the entire tribe; the funds were distributed to him as income pursuant to the tribe's annual budget. 78 T.C. at 138. Even though a Hoptowit treaty contained a provision specifically providing for payments to the tribal chairman, the court found no specific exemption for salary payments made to the chairman and found him liable for federal income taxes on the income. *Id.* at 147. In *Jourdain*, the court similarly held that because the plaintiff received the wages solely for his benefit because of his labor, rather than a pro rata share of tribal income, the wages were subject to federal income taxes. 71 T.C. at 989. (finding that "it does not follow that income received by an employee as compensation for services rendered the tribe is tax exempt because the income earned by the

tribe through (in part) his services is tax exempt.") (citing *Fry v. United States*, 557 F.2d 646, 648 (9th Cir. 1977)). Finally, in *Doxtator v. Commissioner*, the court found that a elected tribal official of the Oneida Indian tribe was liable for taxes on income received from the Tribe because the revenue ruling did not apply to income taxes. T.C. Memo 2005-112, 2005 WL 1163978.

John Barrett was a member of the Citizen Potawatomi Nation Business Committee in 2001, and thus a member of a tribal council, but his income is subject to federal income taxes. The 1959 revenue ruling and interpreting case law leave no question that all of Barrett's income from the Tribe is taxable. Although the proceeds from the Tribe's investment of the trust funds are not subject to tax, Barrett's income is not exempt.

B. The Indian Tribal Judgment Funds Use or Distribution Act Does Not Exempt the Barretts' Income from Taxation.

Barrett's income is subject to taxation because it is distinguishable both from trust funds awarded to tribe members pro rata as well as funds awarded to certain tribal members for medical purposes and as educational scholarships. The Indian Tribal Judgment Funds Use or Distribution Act, as described in the Stipulation of Facts, provides guidelines for the maintenance and distribution of funds awarded to Indian tribes pursuant to claims lodged with the Indian Claims Commission. 25 U.S.C. § 1401, *et seq.* The Citizen Potawatomi Nation submitted various successful claims, and the claims awarded in 1976 and 1984 were to be held in trust by the Secretary for the benefit of the Tribe as provided by statute. Pursuant to plans agreed upon by the Tribe and the Secretary, the majority of the funds held in trust were distributed pro rata to certain members of the Tribe. (Stip. of Facts at ¶¶ 17-19.) In addition, the

Tribe made expenditures from its trust fund to individual tribal members for health aids, prosthetics, and scholarships pursuant to its investment policy. (Stip. of Facts at ¶ 18.)

1. Only Per Capita Distributions are Exempt from Income Taxation.

The funds distributed pro rata to Tribe members were not subject to income tax as provided by 25 U.S.C. § 1407. The statute provides that "[n]one of the funds which are distributed per capita or held in trust pursuant to a plan approved under the provisions of this chapter, ... including all interest and investment income accrued thereon *while such funds are so held in trust*, shall be subject to Federal or State income taxes ... . 25 U.S.C. § 1407(1) (emphasis added). The federal regulations further state that "[a]ll per capita shares, including all interest and investment income thereto, while they are held in trust under the provisions of this section, shall be exempt from federal and state income taxes ... ." 25 C.F.R. § 87.10(e) (2007). The legislative history of the statute provides further guidance that only per capita shares are exempt from income taxes. *See* Ex. 1, H.R. Rep. No. 93-377 (1973) ("Per capita payments authorized under any such plan are exempted from Federal and State income taxes and from being considered as income or resources for purposes of assistance or benefits under the Social Security Act."). Neither the statute, its legislative history, nor the Code of Federal Regulations address the taxability of non-pro-rata payments to individual tribal members.

2. Barrett's Salary is Not an Anticipated Expenditure of the Tribe's Trust Funds.

After the distribution of per capita amounts to Tribe members, the remainder of the funds received from its land claims were to be used by the Tribe for the specific purposes set forth in its 1976 and 1985 distribution plans. The 1976 plan provided that the remaining 20% of the funds, and the income thereon, be used for the acquisition of prosthetic devices for handicapped

or disabled members of the Tribe and as a college scholarship fund. (Stip. of Facts at Ex. 2, p. 2-3.) The 1985 plan provided for the use of the remaining 30% of that year's funds for a Ten Year Tribal Acquisition, Development, and Maintenance plan. (Stip. of Facts at Ex. 3, p. 3-5; 48 F.R. 40567 (1983).) The plan, as approved by the Secretary, provided that "[a]ll expenditures from the program shall be for the benefit of the entire Tribe's economic well-being." *Id.* at 3. Lastly, the 1985 plan required that no member of the Business Committee receive personal payment or property as part of the ten-year plan. *Id.* All expenditures during and after the completion of the ten-year plan were to be subject to the preparation by the Business Committee of an annual tribal budget, with specific line item budgets covering the proposed uses of such funds for the year. *Id.* After the ten-year plan, the general membership of the Tribe was to evaluate the needs of the Tribe and recommend changes to be approved by the Secretary. *Id.*

In 1996, the Tribe removed its trust fund from the Bureau of Indian Affairs to manage the funds itself. (Stip. of Facts at ¶ 23.) In order to receive the funds, the Tribe was required to submit a detailed investment management policy providing guidelines for the maintenance, growth, and distribution of the trust funds. (Stip. of Facts at Ex. 4.) The Tribe's Investment Management Policy for the 2001 year provided that the Business Committee could approve expenditures from the trust fund earnings to beneficiaries of the earnings from the Tribe's Medical Devices and Higher Education Investment Account as well as expenditures from the Investment Account Fund. (Stip. of Facts at Ex. 5, p. 20.) In 1996, the Tribe estimated amounts it would make expenditures from the funds to be spent for medical devices, higher education, and toward the Tribe's ten-year economic development plan. (Stip. of Facts at Ex. 5, p. 30.) The

policy did not describe any expenditures to be used to pay the present or future salaries of tribal officers.

Each of the 1976, 1985, and 1996 investment plans created by the Citizen Potowatomi Nation provided for the use of the income from the trust fund moneys for specified purposes including the purchase of prosthetic devices, college scholarships, and for the acquisition of land or investments. The beneficiaries of these funds, including the recipients of prosthetic devices and scholarships, apparently claimed exemptions from federal income taxes for their awards because such awards were specifically contemplated by each of the Tribe's investment plans. Furthermore, the Secretary of the Interior approved the Tribe's use of the funds for such distributions.

The income Barrett received meets none of the specified purposes for the expenditure of trust fund moneys. None of the 1976, 1985, and 1996 plans provided for the use of income from trust funds for the payment of salaries to the Tribe's executive officers, and no such expenditure was approved by the Secretary of the Interior. In fact, the salary Barrett received was not separately listed on the budget approved by the general membership of the Tribe, as required for expenditures from the 1985 plan. (Stip. of Facts at Ex. 7.) Instead, Barrett's salary is included within the total General Government Expenditures amount and not separately listed as a line-item expenditure. Thus, though the Business Committee approved the salary payments to Barrett, neither the report presented to the general tribal membership nor the audit report presented to the Secretary of the Interior indicates that Barrett's salary was to be paid from the Tribe's earnings on its trust fund. (Stip. of Facts at Ex. 6 at 7; Ex. 7 at 14.)

Although Barrett was earning a salary from the tribe for his daily work, Barrett was paid from the general trust fund solely because he requested such payment so he could claim to be exempt from taxes. The income the Tribe paid to Barrett in 2001 was for his full-time services managing the tribe on a daily basis. (Stip. of Facts ¶ 39.) His salary, as well as the salaries of other Tribe employees, was approved by the Business Committee, except that Barrett requested that he be paid from the income earned on the Tribe's trust fund money, rather than from the indirect fund from which other Tribe employees were paid. In fact, the tribal administrator, whose duties Barrett assumed upon working for the Tribe full-time, was also paid from the Tribe's indirect fund. Had Barrett been paid from the Tribe's indirect fund, his income would have been reimbursable to the Tribe by the federal government and subject to income tax. (Stip. of Facts at ¶ 34.) Furthermore, the entire tribe would have benefitted had Barrett been paid from the indirect fund, as is required for expenditures according to Tribe's investment plan, (Stip. of Facts at Ex. 3, p. 3), because it would have been spending reimbursable moneys. Compensating Barrett from the Tribe's trust fund earnings benefits only him, which is contrary to the purpose and language of the Tribe's investment plans.

The salaries paid from the Tribe's indirect fund are reimbursed because Congress has determined that the administrative costs to operate recognized Indian tribes should be subsidized by the federal government. Congress has not, however, determined that administrative costs paid from a Tribe's trust fund are tax exempt to the individual wage-earner. In *Hoptowit*, the court explicitly rejected the plaintiff's argument that per diem payments to him from the tribe's trust fund were exempt from taxes. 78 T.C. at 147. *See also Jourdain*, 71 T.C. at 989 (finding the petitioner's income taxable because it "did not represent his pro rata share of tribal income.")

Because the payments to Barrett were not for the purchase of prosthetic devices, for a college scholarship, for the acquisition of land, or for any other approved purpose, his income is subject to federal income taxes. Moreover, even if Barrett's income qualifies as a valid expenditure as approved by the Secretary, it is still subject to federal income taxes because the statute exempts only "funds distributed per capita or held in trust," and only applies "while such funds are so held in trust." *See* 25 U.S.C. § 1407; *Moose v. United States*, 674 F.2d 1277, 1282 (9th Cir. 1982) ("This language [§ 1407] indicates that Congress regarded only undistributed Indian judgment funds as 'held in trust.'"). The statute does not provide that other non-per-capita distributions are exempt from taxes, so as soon as the Tribe distributed Barrett's income from its trust fund account, the funds lost their trust status and became taxable to Barrett.

C. The Internal Revenue Manual Does Not Exempt the Barretts' Income from Taxation.

The Internal Revenue Manual does not provide for the exemption of income received by a member of an Indian tribe from federal income taxes. Although the plaintiffs have indicated that the Internal Revenue Manual contains such an exemption, we are unable to find *any* provision of the 2001 Manual providing for the taxability of income received by members of an Indian tribe. The 2005 version of the Internal Revenue Manual, however, is illustrative. The 2005 Manual lists several items excluded from the taxable income of individual tribal members, including: 1) income directly derived by the Indian allottee from restricted allotted land that is held in trust by the United States Government, 2) income derived from a fishing rights-related activity, 3) income that is exempt under treaty or statute, 4) income received from land claim settlements and judgments pursuant to 25 U.S.C. § 1401, 5) or benefits via tribal programs which provide need-

based governmental services.[2] (Ex. 5 at 2, I.R.M. § 4.88.1.6.3.1 (2005).) Barrett's income was received for his services managing the tribe on a daily basis, but he apparently contends that his income qualifies as income received from land claim settlements.

The Internal Revenue Manual cites 25 U.S.C. § 1401, the Indian Tribal Judgment Funds Use or Distribution Act, which provides that pro rata distributions from a tribe's trust fund are not taxable to the recipient. As discussed above, the statute does not exempt wage income received by individual tribe members for services rendered to the tribe. The Internal Revenue Manual merely contains a brief summary of the types of income exempt, and refers the reader to the applicable tax code for further explanation of the tax consequences of such income. Moreover, the Barretts argument has been rejected in *Walker*, wherein the court found that payments to a tribe's Treasurer from revenue from common tribal lands did not constitute income "directly derived from tribal lands." 326 F.2d at 263-64. *See also Critzer v. United States*, 597 F.2d 708 (Ct. Cl. 1979) (holding that income derived by tribe member from operating several businesses on tax-exempt tribal lands did not meet the "directly-from-the-land" standard and was taxable.)

Most important, even if the Manual did explicitly provide that such income was exempt from taxes, the Manual has no force and effect of law. *See Rosenberg v. Commissioner*, 450 F.2d 529, 532-33 (10th Cir. 1971); *Einhorn v. Dewitt*, 618 F.2d 347, 350 (5th Cir. 1980). The manual provides guidance for the internal administration of the IRS, but does not confer any rights upon a taxpayer. *United States v. Will*, 671 F.2d 963, 967 (6th Cir. 1982). Thus, even assuming the plaintiffs interpretation of the Manual was correct, they cannot rely solely on the internal revenue

[2] The 2007 version of the Internal Revenue Manual contains the same excluded items, but instead cites 25 U.S.C. § 1417. I.R.M. §§ 4.88.1.10 and 22.41.1.6 (2006).

manual because absent a specific exemption provided by statute, Barrett's income is subject to federal taxes.

D. No Other Law Exempts the Barretts' Income from Taxation.

The plaintiffs have cited a host of other federal statutes in support of exempting Barrett's income from taxation, but their reliance is misplaced. For example, the Oklahoma Indian Welfare Act, enacted in 1936, authorizes the Secretary of the Interior to acquire interests in property to be held in trust for the benefit of federally-recognize Indian tribes or their members. *See* 25 U.S.C. §§ 501, *et seq.* The act further specifies that "while the title thereto is held by the United States said lands shall be free from any and all taxes." *Id*. The payments the Citizen Potawatomi Nation made to the plaintiff for his services plainly do not fit into this narrow category of tax-exempt land because the trust fund moneys were not held by the United States since 1996 and Barrett received income, not land. Furthermore, the funds were not purchased or obtained for the purpose of the Tribe or its members, but instead were the proceeds of specific claims filed by the Tribe against the United States as payment for lands unlawfully taken.

Plaintiffs may alternatively argue that Internal Revenue Code section 1033 exempts Barrett's wages from federal income taxes. Section 1033, enacted as section 112(f) in 1951, provides that taxpayers recognize no gain upon receiving income or property from an involuntary conversion of property, subject to certain restrictions. 26 U.S.C. § 1033. The statute applies where property is seized by eminent domain or stolen. The statute does not, however, exempt Barrett's income from federal income taxes because any properly allegedly converted was taken from the Citizen Potawatomi Nation, rather than Barrett himself. As described in the Stipulation of Facts, the Citizen Potowatomi Nation submitted claims to the Indian Claims Commission

(ICC) seeking reimbursement for lands unlawfully seized from the Tribe. (Stip. of Facts at ¶ 16.) The Tribe did not submit claims regarding takings from individual members of the tribe. Thus, any funds received from the ICC claims are solely the property of the Tribe to use, subject to the approval of the Secretary of the Interior. Moreover, the statute only applies to property converted within the year for which the taxpayer seeks non-recognition of the gain. Any alleged taking of the Citizen Potawatomi Nation lands occurred well before 2001, and the statute simply does not apply. Any argument that section 1033 exempts Barrett's income from taxation should not be sustained.

The plaintiffs will likely argue that Barrett's income is exempt pursuant to 25 U.S.C. § 881. The statute provides that

> The funds on deposit in the Treasury of the United States to the credit of the Citizen Band of Potawatomi Indians of Oklahoma ... to pay a judgment by the Indian Claims Commission in docket numbered 96 dated August 27, 1968, and the interest thereon, ... may be advanced or expended for any purpose that is authorized by the tribal governing body and approved by the Secretary of the Interior. Any part of such funds that may be distributed per capita to the members of the band shall not be subject to Federal or State income tax.

25 U.S.C. § 881 (2007). The statute clearly applies only to per capita payments to the Tribe members. As discussed above, Barrett's income was for services rendered rather than as a per capita distribution to Tribe members. *See* discussion *supra* § II.A. As such, § 881 does not apply.

E. The Barretts Are Liable for the Penalties Assessed for their Understatement of Tax.

The plaintiffs assert that even if the Court finds they are liable for taxes on the $48,057.64 earned by Barrett in 2001, they are not liable for the accuracy-related penalty assessed pursuant to 26 U.S.C. § 6662. The accuracy-related penalty is assessed for any underpayment of tax attributable to a taxpayer's "negligence or disregard of rules or regulations," or for any

underpayment of tax exceeding the greater of ten percent of the tax required to be shown or $5,000. 26 U.S.C. § 6662 (2007). Negligence includes "any failure to make a reasonable attempt to comply with the provisions of this title," and disregard includes "any careless, reckless, or intentional disregard." 26 U.S.C. § 6662(c). The code further provides that the amount of an underpayment will be reduced if there is substantial authority for such treatment, or if the relevant facts affecting the item's tax treatment are adequately disclosed in the return and there is a reasonable basis for the tax treatment of such item by the taxpayer. 26 U.S.C. § 6662(d)(2)(B). The penalty does not apply if there was reasonable cause for the underpayment and the taxpayer acted in good faith with regard to such underpayment. 26 U.S.C. § 6664(c)(1); *Intertan Inc. v. Commissioner*, T.C. Memo 2004-1, 87 T.C.M. (CCH) 767, 2004 WL 25249. The United States has the burden of production regarding the penalty, 26 U.S.C. § 7491(c), which is satisfied by introducing "sufficient evidence indicating that it is appropriate to impose the relevant penalty." *Higbee v. Commissioner*, 116 T.C. 438, 446, 2001 WL 617230 (2001). The taxpayer is required to introduce evidence regarding reasonable cause, substantial authority, or similar provisions. *Id.*

The plaintiffs are liable for the penalty because they intentionally failed to disclose Barrett's income despite the complete lack of authority supporting their position. They did not act in good faith. In 1990, the IRS issued a Notice regarding the applicability of the accuracy penalty. Ex. 2, I.R.S. Notice 90-20, 1990-1 C.B. 328. The Notice stated that "the Service will not impose the penalty under sections 6662(b)(1) and (c), relating to negligence or disregard of rules or regulations, with respect to a nonfrivolous position if the taxpayer has made a complete, item-specific disclosure of such nonfrivolous position. Such disclosure must be full and substantive and be clearly identified as being made to avoid imposition of the accuracy-related

penalty." *Id.* The Notice further provided specific rules for the proper disclosure of any nonfrivolous position, including the filing of a Form 8275. In 1994, the IRS described another method whereby a taxpayer can disclose a tax position via a statement submitted to the IRS. Rev. Proc. 94-69, 1994-2 C.B. 804, 806. The Barretts did not file a Form 8275 or submit a statement disclosing the income Barrett received from the Tribe. (Stip. of Facts at ¶ 4.)

Despite having notice of the rules regarding the application of the penalty, the plaintiffs nevertheless failed to disclose the $48,057.64 Barrett received from the Citizen Potawatomi Nation. (Stip. of Facts at ¶ 4.) At all times, Barrett was fully aware that he had received such income, and it was because of Barrett that the Tribe failed to report the income it paid to the Internal Revenue Service. Upon unilaterally deciding that his income was exempt from taxes in 1996, Barrett told the Tribe's accounting department not to issue him a Form W-2 reporting the wages he had earned. (Stip. of Facts at ¶ 38.) Thus, the Tribe did not issue Barrett a Form W-2 or a Form 1099 reporting his income. Because of Barrett's direction to the accounting department and his failure to notify the IRS of the exclusion, the IRS was not aware of the unreported income until a confidential informant told the IRS agents that Barrett was receiving income that he was not reporting. (Ex. 3, Robinson Decl. at ¶¶ 3-4.)

Furthermore, the plaintiffs' position is not based on any fact or authority. The United States has been unable to find *any* authority supporting the plaintiffs' position that Barrett's income from the Tribe is exempt from taxes. In fact, all of the cases we found considering Revenue Ruling 59-354 have rejected taxpayers' arguments that income received by members of tribal councils are exempt from income taxes. *See* discussion *supra* § II.A. We found no cases considering the applicability of the Indian Tribal Judgment Funds Use or Distribution Act to salary payments to tribal members paid from trust fund moneys. *See* discussion *supra* § II.B.

Similarly, we found no private letter rulings or other administrative rulings finding that such income is exempt from taxes.

Courts have found the negligence penalty not to apply in certain situations where a taxpayer relied on professional advice, if such reliance is reasonable. *See Mauerman v. Commissioner*, 22 F.3d 1001, 1006 (10th Cir. 1994), *superseded by statute on other grounds*; *Van Scoten v. Commissioner*, T.C. Memo. (RIA) 2004-275 (2004). Furthermore, to determine whether the taxpayer had reasonable cause and acted in good faith under § 6664, courts consider the taxpayer's efforts to determine the proper liability, the knowledge of the taxpayer, and the reliance on a tax professional. Treas. Reg. § 1.6664-4(b)(1); *Intertan*, T.C. Memo 2004-1. The plaintiffs have not shown that they relied on or sought any professional advice, or that they have any special knowledge regarding federal income taxes. Instead, they decided for themselves that their income was exempt and filed their tax return excluding the income.

Even if the plaintiffs legitimately believed that Barrett's income was exempt from taxation, they cannot show that such belief was reasonable absent any legal or factual basis for such belief. Absent any specific statement, case or statute stating that Barrett's income was exempt from taxation as required, *see* discussion *supra* § II, the plaintiffs could not have reasonably believed their exclusion of Barrett's income was justified. The plaintiffs furthermore failed to act in good faith when Barrett requested that the Tribe not issue him a Form W-2, which essentially guaranteed that the IRS would not be aware of the income he received. Had the plaintiffs requested a private letter ruling or otherwise disclosed to the IRS their proposed treatment of Barrett's income, the penalty may not have applied. Yet, because the plaintiffs intentionally and carelessly failed to report their full income, they are fully liable for the § 6662 penalty assessed by the IRS in the amount of $3,871.

III. CONCLUSION

Congress has provided that certain income to members of Indian tribes is exempt from taxes, but Barrett's income for services he provided is not exempt. The Indian Tribal Judgment Funds Use or Distribution Act clearly provides that only per capita payments to tribe members are exempt from taxation, and the 1959 revenue ruling provides only that Indian tribes are exempt from FICA and FUTA taxes for wages paid to tribal council members. Plaintiffs John and Sheryl Barrett earned $48,057.64 in taxable income for the year 2001 that they did not report on their original income tax return, and they are fully liable for the accuracy penalty for their negligent disregard of applicable case law and failure to notify the IRS of their unreported income. The United States therefore requests that the Court grant summary judgment in its favor.

Respectfully submitted,

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Dated: September 7, 2007

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT has been made upon the following by depositing a copy in the United States mail, postage prepaid, this 7th day of September, 2007.

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