No. 08-6017

IN THE UNITED STATES COURT OF APPEALS

FOR THE TENTH CIRCUIT

JOHN A. BARRETT, JR. AND SHERYL S. BARRETT,

Plaintiffs-Appellants

v.

UNITED STATES OF AMERICA,

Defendant-Appellee

ORAL ARGUMENT REQUESTED

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA (JUDGE JOE HEATON)

BRIEF FOR THE APPELLEE

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STATEMENT OF PRIOR OR RELATED APPEALS

Pursuant to local rule 28.2(C)(1) of this Court, counsel for the Commissioner state that they are not aware of any prior or related appeals that have been brought to or that currently are pending in this Court.

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STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

On June 16, 2005, the Commissioner of Internal Revenue (Commissioner) issued to John A. Barrett, Jr. (taxpayer) and Sheryl S. Barrett (collectively, taxpayers) a notice of deficiency determining a deficiency in their federal income tax, and a penalty, for the year 2001. (Aplt. App. 238-251.) 1/ On September 6, 2005, taxpayers paid

1/ "Aplt. App." references are to the documents in the Appellants'
(continued...)

$38,623.73 to the IRS for all of the amounts assessed with respect to their 2001 income tax liability and penalty (and an overpayment, which was credited to 2004). (Aplt. App. 29, 254, 257.) In March 2006, taxpayers filed a Form 1040X, amended income tax return for 2001, requesting a refund of the amounts paid for 2001. (Aplt. App. 29.) The Form 1040X was a timely claim for refund under Internal Revenue Code (I.R.C.) § 6511(a) (26 U.S.C.) because it was filed within two years of the date the tax was paid.

By letter dated May 10, 2006, the IRS denied taxpayers' refund claim. (Aplt. App. 11-18, 29.) On September 8, 2006, taxpayers filed the complaint in this action with the District Court, seeking review of the IRS's denial of their refund claim. (Aplt. App. 2, 8-18.)

The District Court had jurisdiction over the complaint because it was filed within two years of the date taxpayers' refund claim was denied. Internal Revenue Code (I.R.C.) §§ 6532(a), 7422 (26 U.S.C.); 28 U.S.C. § 1346(a)(1). This Court has jurisdiction to hear this appeal pursuant to 28 U.S.C. § 1291.

1/(...continued)
Appendix, filed by the Appellants concurrently with the filing of their opening brief.

STATEMENT OF THE ISSUES

1. Whether the District Court correctly held that taxpayers were not entitled to a refund because the salary paid to taxpayer by the Tribe was not exempt from taxation.

2. Whether the District Court correctly sustained the imposition of the penalty for negligence or substantial disregard of rules and regulations.

STATEMENT OF THE CASE

Taxpayers did not report as income the amount paid to him in 2001 for his services as Chairman of the Tribe. The IRS determined that taxpayer's salary was taxable, and that taxpayers, accordingly, owed additional tax and a penalty. Taxpayers paid the additional amount and filed a claim for refund, which was denied. They then brought this suit for refund. On cross-motions for summary judgment, the District Court held in favor of the United States, sustaining both of the IRS's determinations.

STATEMENT OF FACTS

1. *Background of the Citizen Potawatomi Nation*

In the late 1940s and early 1950s, the Citizen Potawatomi Nation (the Tribe), a federally recognized tribe of American Indians, brought various claims against the United States, pursuant to the Indian Claims Commission Act, with respect to certain lands that had been owned or occupied by the Tribe and that had been taken by the United States without compensation or without adequate compensation. (Aplt. App. 24.) In the mid to late 1970s, awards were made by the Indian Claims Commission with respect to some of the claims. (Aplt. App. 24.) Under a distribution plan approved by the Secretary of the Interior (Secretary), 80% of the award money was distributed *pro rata* to the members of the Tribe, and 20% of the award money was held in perpetual trust by the Secretary, with the income from the trust funds to be used for specific Tribe expenses such as health aids, prosthetics, and scholarships. (Aplt. App. 24, 45-47.) Disbursements of income from the trust funds for health aids, prosthetics, and scholarships were not taxable income to the recipients. (Aplt. App. 25.)

In the 1980s, more awards were made to the Tribe by the Indian Claims Commission with respect to the remaining claims. (Aplt. App.

25.) In conjunction with the payments, the Indian Tribal Judgment Funds Use or Distribution Act (ITJFUDA), 25 U.S.C. §§ 1401 - 1408, provided that none of the funds distributed *per capita* or held in trust pursuant to a plan approved under the provisions of the ITJFUDA, including interest accruing on the funds while they are held in trust, would be subject to state or federal income tax. 25 U.S.C. § 1407. Under the distribution plan approved by the Secretary for these funds, known as the 1983 Plan, 48 F.R. 40567, 70% was distributed *pro rata* to the members of the Tribe, and 30% was to be held in perpetual trust by the Secretary. (Aplt. App. 25.) Under the Guidelines issued by the Tribe in 1985 (the 1985 Guidelines), which were approved by the Secretary, income from the trust funds was to be used for a Ten-Year Tribal Acquisition, Development and Maintenance Plan, which included real estate acquisition, development of the Tribe's assets (including the effectiveness of the Government), and the maintenance of Tribal property. (Aplt. App. 25, 48-53.) The 1985 Guidelines defined the terms "acquisition," "development," and "maintenance." (Aplt. App. 50-51.)

Following passage of the American Indian Trust Fund Reform Act of 1994, the Tribe withdrew all trust funds from the control and management of the Secretary, and took over managing the funds itself. (Aplt. App. 25-26.) After withdrawal, the funds maintained their status as trust funds. (Aplt. App. 26.)

2. *Taxpayer's salary from the Tribe and the proceedings below*

Taxpayer is a member of the Tribe, and he has been involved with its governance since 1971. (Aplt. App. 22-23.) In 1985, he was elected Chairman of the Tribe, and he has been re-elected Chairman each year since then, at least through the time of the proceedings below. (Aplt. App. 23.) Initially, taxpayer was able to spend only 20 hours per week fulfilling his duties as Chairman because of other commitments to non-tribal related businesses; in 1996, he became Chairman on a full-time basis. (Aplt. App. 27-28.)2/ Taxpayer also is a successful businessman, with interests in oil and gas production, cattle ranching, and land development. (Aplt. App. 23.) In addition, he and a partner developed a casino in Mississippi. (Aplt. App. 343.)

2/ According to taxpayers' brief (Br. 4-5), he continues to hold several outside positions, including: President, Barrett Drilling Company; President, Barrett Land and Cattle Company; Chairman of the Board, Rainbow Development Corporation; and Oklahoma Delegate to the National Tribal Self Governance Advisory Committee. Taxpayer also serves as Chairman of the Board of First National Bank & Trust Co., which is owned by the Tribe. (Br. 4.)

Sometime in 1993, taxpayer became aware of certain Revenue Rulings, including Rev. Rul. 59-354 regarding the taxability of payments to tribal council members. (Aplt. App. 28.) In 1996, taxpayer concluded that his salary as Chairman could be paid from the earnings accrued on the Tribe's trust fund, and that he would not be taxed on that income. (Aplt. App. 28.) He suggested to the Business Committee of the Tribe (of which he, as Chairman, was a member) that he be paid from those funds, and so informed the accounting department. (Aplt. App. 28.) He also instructed the accounting department not to withhold taxes from his compensation and not to issue him a Form W-2. (Aplt. App. 28.)

For the year 2001, taxpayers filed a joint federal income tax return reporting adjusted gross income of $789,495, with a total tax liability of $266,013, which they paid in full. (Aplt. App. 22.) Taxpayers, however, did not report on their return the $48,057.64 paid to taxpayer by the Tribe in 2001 for his services as Chairman. (Aplt. App. 23.) Following an audit, the IRS determined that the compensation paid by the Tribe to taxpayer was taxable income. (Aplt. App. 28.) Taxpayers disagreed, but paid the additional tax and penalty, and then filed a claim for refund. (Aplt. App. 29, 254, 257.)

When the claim was denied, they brought this suit for refund. (Aplt. App. 8-18, 29.)

In the District Court, the parties submitted a stipulation of facts, with exhibits, and then filed cross-motions for summary judgment. (Aplt. App. 22-345.) The District Court denied taxpayers' motion and granted the motion of the United States. (Aplt. App. 396-409.)

In its order, the District Court rejected taxpayers' argument that the compensation paid by the Tribe to taxpayer was exempt from income tax because it fell within the 1985 Guidelines' definition of "development." (Aplt. App. 401-402.) The Court concluded that although Congress had approved the 1983 Plan, there was no evidence that it had approved the 1985 Guidelines, and that the Guidelines could not expand the tax exemption created by Congress. (Aplt. App. 402.) The District Court also held that the compensation paid to taxpayer was not a "programming expenditure" as that term is used in the 1983 Plan. (Aplt. App. 403.) The Court agreed with the United States that, even if the funds paid to taxpayer could be considered an exempt expenditure under the 1983 Plan, that Ten-Year Plan had expired long before 2001, and did not apply to any later payments from the trust fund income. (Aplt. App. 403-404.) The Court further noted that taxpayers cited no other basis for their claimed tax exemption, and that the case law was to the contrary. (Aplt. App. 404-405.)

Finally, the District Court held that imposition of the accuracy-related penalty under I.R.C. § 6662 should be sustained. (Aplt. App. 405-409.) The Court noted that to avoid the penalty taxpayers were required to establish both that they had acted with reasonable cause and in good faith. It concluded that while there might be a factual question as to taxpayers' subjective good faith, they had not presented sufficient evidence to create a triable issue of fact as to the objective reasonableness of their position regarding the taxability of taxpayer's salary. (Aplt. App. 407-408.)

Taxpayers now appeal.

SUMMARY OF ARGUMENT

Taxpayer, a successful businessman and a member of the Citizen Potawatomi Nation, was employed as Chairman of the Tribe in 2001, for which he received a salary of $48,057.64. Taxpayers did not include or disclose the salary on their federal income tax return for 2001. The IRS determined that the salary was taxable income; taxpayers paid the tax and then brought this suit for refund.

Taxpayers contend that the salary payment was not taxable to them because it was paid from certain trust funds that had been awarded to the Tribe in satisfaction of judgments awarded by the Indian Claims Commission with respect to land taken by the United States without payment of adequate consideration. Under the terms of the ITJFUDA, the statute governing disbursements of the funds, none of the funds paid to Tribe members *per capita* (which was 70% of the money), or held in trust (which was the remaining 30%) pursuant to an approved plan, would be subject to state or federal income tax. The plan approved in 1983 for disbursement of these trust funds, known as the "programming" funds, provided that they were to be used in a Ten-Year Tribal Acquisition, Development, and Maintenance Plan, which consisted of real estate acquisition, development of the Tribe's assets, and maintenance of Tribal property. The Tribe passed a resolution in which it defined "development" under the plan to include strengthening or building up Tribal government. The Tribal guidelines also contained a provision that no member of the Business Committee (which included taxpayer) could receive a direct personal payment as a result of a project funded by the programming funds.

The District Court correctly granted summary judgment for the Government, because the compensation paid to taxpayer was not exempt from tax. Exemptions from tax must be narrowly construed. Native Americans are subject to the payment of income taxes, as are other citizens, absent an explicit exemption in a statute or treaty. The salary paid to taxpayer here did not fit within the statute's definition of "programming expenses," *viz.*, land acquisition, development of tribal assets, and maintenance of tribal property, and it therefore was subject to tax. Guidelines promulgated by the Tribe cannot expand the tax exemption approved by Congress. Indeed, the Tribe's guidelines do not support taxpayer's position inasmuch as they provide that tribal officers cannot received funds directly through a funded project.

Further, the case law is overwhelmingly against taxpayer's position. So far as we are aware, no court has held that salary paid to a tribal officer or employee is exempt from tax. And numerous decisions have rejected theories similar to the one advanced by taxpayers in this case.

Finally, the District Court correctly sustained imposition of the penalty for negligence or disregard of rules and regulations. Taxpayers did not meet their burden of proving that they had reasonable cause and that they acted in good faith. Their good faith is suspect, given that they omitted the salary from their return, and that taxpayer instructed the tribal accounting office not to withhold taxes from his salary and not to issue him a Form W-2. But even if there might be a triable fact question of subjective good faith, the District Court's conclusion that they failed to establish reasonable cause as to an objective matter is not clearly erroneous. Taxpayers submitted no evidence showing that they made an attempt to ascertain whether their position was correct; they merely decided on their own, without consulting professional advisors, that they did not owe tax on the salary, despite their lack of expertise in this area. Further, there was no substantial authority supporting their position. Indeed, there is no authority remotely on point that supports the tax exemption they claimed. And their reliance on the ITJFUDA was not reasonable; it applies to *per capita* payments to tribal members, and it certainly does not explicitly provide that salary paid to a tribal officer is exempt from tax.

The decision of the District Court is correct and its judgment should be affirmed.

ARGUMENT

I

THE DISTRICT COURT CORRECTLY HELD THAT TAXPAYER'S SALARY WAS NOT EXEMPT FROM INCOME TAX

Standard of Review

This Court reviews the grant of summary judgment *de novo*. *Rogers v. Anheuser-Busch, Inc.*, 491 F.3d 1165, 1169 (10^{th} Cir. 2007).

A. Introduction

1. Federal tax law

Under I.R.C. § 61(a), gross income means "all income from whatever source derived" except as otherwise provided by the Internal Revenue Code. In order to be entitled to an exemption from the income tax, a taxpayer must establish that his accession to wealth is rendered tax free as a matter of law. Courts give effect to the broad statutory definition of gross income by interpreting the statutory exclusions from gross income narrowly. *See United States v. Burke*, 504 U.S. 229, 233 (1992); *Dotson v. United States*, 87 F.3d 682, 684-85 (5th Cir. 1996).

It has long been established, moreover, that these rules apply in the case of Native Americans, who, except as dictated by "treaties or remedial legislation, . . . are subject to the payment of income taxes as are other citizens." *Squire v. Capoeman*, 351 U.S. 1, 6 (1956). *See United States v. White*, 237 F.3d 170, 172 (2d Cir. 2001) (quoting *Squire v. Capoeman*, as above); *Cook v. United States*, 86 F.3d 1095, 1097 (Fed. Cir. 1996) ("Absent a definitely expressed exemption, Indians, like all other United States citizens, are subject to federal taxation"); *Lazore v. Commissioner*, 11 F.3d 1180, 1183 (3d Cir. 1993); *Hoptowit v. Commissioner*, 709 F.2d 564, 565 (9th Cir. 1983); *Jourdain v. Commissioner*, 71 T.C. 980, 987 (1979), *aff'd*, 617 F.2d 507 (8th Cir. 1980).

2. The Tribe's trust funds

As enacted in 1973, the ITJFUDA provided for the satisfaction of judgments awarded by the Indian Claims Commission, including certain claims brought successfully by the Tribe. With respect to the taxability of payments made under the ITJFUDA, the statute provided as follows (25 U.S.C. § 1407):

> None of the funds which --
>
> > (1) 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 . . . .

Use and distribution of the funds that were held in trust for the Tribe (at least to the extent of the funds in issue here) was controlled by the 1983 Plan, 48 F.R. 40567, which was approved by the Secretary and which became effective on July 17, 1983. 48 F.R. 40567; 25 U.S.C. § 1405(a).3/ Under the terms of the 1983 Plan, the 30% of the funds that was not paid out *per capita* to the individual members of the Tribe, known as the "programming" funds, was to be used in a "Ten-Year Tribal Acquisition, Development, and Maintenance Plan." 48 F.R. 40567 § 5(d). The 1983 Plan directed that the Ten-Year Plan would include "the acquisition of additional lands to build upon the tribal land base, the development of the tribe's assets and . . . the maintenance and care of the tribal property." 48 F.R. 40567 § 5(d).

The 1983 Plan also required the Business Committee of the Tribe to prepare administrative guidelines and plans for the Ten-Year Plan, separate from the annual line-item tribal budgets, which would be subject to approval by the Secretary. 48 F.R. 40567 § 5(d)(ii). The 1983

3/ ITJFUDA provides that a plan prepared by the Secretary will become effective at the end of the 60-day period following the day it is submitted to Congress, unless during that period Congress passes a joint resolution disapproving the plan. 25 U.S.C. § 1405(a). Thus, Congress approved this plan by its inaction.

Plan specified that at the end of the ten-year program period, the General Council of the Tribe would "evaluate tribal needs as concerns the remaining balances in the program principal and interest accounts," and would submit any proposed changes to the Secretary. 48 F.R. 40567 § 5(d)(iii). Finally, the 1983 Plan stated that "[n]one of the funds distributed per capita or made available under this plan for programming shall be subject to Federal or State income taxes . . . ." 48 F.R. 40567 § 6(b).

Pursuant to the directives of the 1983 Plan, the Tribe in 1985 promulgated a resolution containing guidelines for the use of the programming funds, also referred to as the "30% set aside" funds. (Aplt. App. 48 - 53.)4/ These 1985 Guidelines defined "development" to include activities or actions that would "in some way cause growth, building up, expansion, strengthening, increased effectiveness or other evolutionary process toward the progress of the Tribe economically and/or socially, and/or governmentally." (Aplt. App. 51.) The 1985

4/ One of the policies of the 1985 Guidelines was that the principal of the 30% set aside funds should remain intact, and that the programs should be funded from interest earnings only, unless it was absolutely necessary to utilize principal. (Aplt. App. 50.) It appears from the record that the funds in issue here represented interest earned on the set-aside funds.

Guidelines also provided that no member of the Business Committee or any elected body of the Tribe "may receive personal payment or property as a result of any project funded by these monies." (Aplt. App. 51.)

In 1994, Congress passed the American Indian Trust Fund Management Reform Act of 1994, 25 U.S.C. §§ 4001, 4011-4012, 4021-4029, 4041-4046, 4061, which made it possible for Indian tribes to assume control of their trust funds. The Act provided for tribes to submit plans to the Secretary, who would approve them and release the funds. 25 U.S.C. § 4022. In approving the plans, the Secretary was charged with ensuring that "the purpose and use" of the funds as set forth in the previously approved judgment fund plan would continue to be followed by the tribes in managing their own funds. 25 U.S.C. § 4023.

Pursuant to the American Indian Trust Fund Management Reform Act, the Tribe in 1996 withdrew its trust funds from the control and management of the Secretary, and took over managing the funds itself. (Aplt. App. 25-26.) After withdrawal, the funds maintained their status as trust funds. (Aplt. App. 26.) The Tribe submitted an Investment Management Policy to the Secretary in which it set forth its plans for managing the trust funds. (Aplt. App. 57-92.) The Investment Management Policy did not specifically refer to the 1983 Plan, but it did state that the "purpose and use" of the earnings on the trust funds would "be consistent with the original claims settlements, to wit: for medical devices (*i.e.*, prosthetics, dentures, eyeglasses), higher education/scholarships and a general purpose investment fund." (Aplt. App. 63.)

B. Taxpayers have not shown that any treaty or law exempts them from paying federal income tax on the salary taxpayer received from the Tribe

Taxpayers acknowledge (Br. 15) the "general rule" that American Indians are subject to federal income tax just like other citizens, unless there is an applicable exemption that is "derived plainly from the Federal tax statutes, or from treaties or agreements with the Indian Tribes concerned . . . ." They maintain, however, that the salary taxpayer received in 2001 from the Tribe is exempt from taxation under § 6(b) of the 1983 Plan, which provides that funds made available for "programming" will not be subject to federal or state income tax. (Br. 15-16.) Taxpayers are wrong, however, and their argument properly was rejected by the District Court.

The 1983 Plan called for the programming funds to be used in a "Ten-Year Tribal Acquisition, Development, and Maintenance Plan." 48 F.R. 40567 § 5(d). It specified only that the Ten-Year Plan would include "the acquisition of additional lands to build upon the tribal land base, the development of the tribe's assets and . . . the maintenance and care of the tribal property." 48 F.R. 40567 § 5(d). Nothing in the language of the 1983 Plan indicates that it was intended to encompass the payment of salaries to tribal employees. Thus, even if the salary paid to taxpayer as chairman of the Tribe were treated as falling within the intended uses of the programming funds, the reference to tax exemption in the 1983 Plan is not sufficiently specific to meet the standard required for an individual taxpayer's salary to be considered exempt from federal taxation. *See Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 156 (1973) (Indian claiming tax exemption must point to "express exemptive language in some statute or treaty"); *Boulden v. Commissioner*, 70 T.C.M. (CCH) 216, T.C. Memo. 1995-347, *aff'd without pub. op.*, 77 F.3d 467 (4th Cir. 1996) (exemptions from tax must be unambiguously proved). In any case, the 1983 Plan, although approved by Congress, is not a statute or a treaty, but merely a plan promulgated in accordance with a statute, the ITJFUDA. And that statute did not expressly address the issue of tax treatment of funds paid to individual tribal employees for services rendered to the Tribe.

Taxpayers rely (Br. 16) on the language of the 1985 Guidelines, in which “development” is defined to include strengthening the effectiveness of tribal government (Aplt. App. 51), to support their claim that taxpayer’s salary is exempt from taxation. The 1985 Guidelines, however, were not approved by Congress, but were generated by and for the Tribe. They therefore cannot be construed to have the imprimatur of Congressional approval of the tax exemption that taxpayers impute to that definition. The rather vague and general language as to strengthening effective tribal government used in the 1985 Guidelines certainly does not constitute a definitely expressed exemption in a statute, treaty, or other agreement between Congress and a Native American tribe. As the District Court correctly held (Aplt. App. 402), the 1985 Guidelines cannot expand the income tax exemption created by Congress.

The same principle applies to the Investment Management Policy (IMP), which taxpayers also cite as authority for their claimed tax exemption. The IMP was created by the Tribe for its internal use and, although it was submitted to the Secretary, was not approved by

Congress. (Aplt. App. 26.) Taxpayers cannot rely upon any provision of this policy to support their position.

Taxpayers fare no better under the ITJFUDA or the 1983 Plan, which was promulgated pursuant to the provisions of the ITJFUDA. The ITJFUDA provides only that the funds distributed *per capita* or held in trust, including interest accruing while the funds are held in trust, will not be subject to state or federal income tax. 25 U.S.C. § 1407. The 1983 Plan provides that the interest from the funds held in trust is to be used for certain programming expenditures as part of a Ten-Year Plan that includes acquisition of land, development of the tribe's assets, and maintenance of tribal property. 48 FR 40567, § 5(d). None of these categories reasonably can be construed to include payment of the Chairman's salary, and the Plan certainly does not explicitly provide that part of the intended programming expenditures is for the payment of a tribal official's salary. In fact, the 1983 Plan dictates that the Business Committee is required to prepare administrative guidelines and plans of operation for the Ten-Year plan that are to be "separate from annual line item tribal budgets." 48 F.R. 40567, § 5(d)(ii). This language strongly suggests, if it does not compel, the conclusion that the regular annual tribal budget, which presumably would include salaries for tribal officers, is to be kept separate and apart from the programming funds used for the Ten-Year Plan.

Further, the Tribe's own 1985 Guidelines contain a section entitled "Conflict of Interest," which provides that no member of the Business Committee, or any elected or appointed body of the Tribe, or any relative thereof, is permitted to receive "personal payment or property" through one of the projects funded by the set-aside or programming funds under the Ten-Year Plan. (Aplt. App. 51.) Taxpayer, as a member of the Business Committee and an elected officer of the Tribe, therefore would be ineligible to receive direct payment from these funds under the Tribe's official interpretation of the 1983 Plan.

It bears noting that the Tax Court and two courts of appeals have held that amounts received by Native Americans for serving as tribal council members are not exempt from tax. *Allen v. Commissioner*, 91 T.C.M. (CCH) 673, T.C. Memo 2006-11, *aff'd without pub. op.*, 204 Fed. Appx. 564 (7th Cir. 2006) (chairman of tribe liable for tax on his salary; fact that tribe is non-taxable entity is irrelevant); *Hoptowit v. Commissioner*, 78 T.C. 137, 145-148 (1982), *aff'd*, 709 F.2d 564 (9th Cir. 1983) (tribal council member liable for tax on payments received from tribe's trust fund); *Commissioner v. Walker,* 326 F.2d 261, 264 (9th Cir. 1964) (even though employer organization (tribe) is exempt from taxation, it does not follow that income received by employee for services rendered is also exempt from tax); *Jourdain v. Commissioner*, 71 T.C. at 987 (tribal chairman's salary paid from tribal trust funds is taxable to him); *Doxtator v. Commissioner*, 89 T.C.M. (CCH) 1270, T.C. Memo. 2005-113 (tribal official subject to income tax on compensation received for services rendered to the tribe, absent exemption by treaty or statute); *Allen v. Commissioner*, T.C. Memo. 2005-118 (no treaty or legislation exempts taxpayer from tax on income received for services rendered to tribal council). Although the income from certain Indian lands may be tax-exempt, the payment of that income (or interest earned on the trust funds derived from tribal lands) to tribal officers in exchange for services rendered is a taxable event. *Hoptowit*, 709 F.2d at 566; *Walker*, 326 F.2d at 264.

Taxpayers have not pointed to any authority that supports their claim that their situation is different from those dealt with in these cases. Rather, they contend that the District Court erred in its construction of the ITJFUDA and the 1983 Plan, asserting (Br. 21) that "statutes passed for the benefit of dependent Indian tribes . . . are to be liberally construed to favor Indians" (quoting *Bryan v. Itasca County*, 426 U.S. 373, 392 (1976)). But that case concerned a state property tax issue, not a federal income tax issue. Federal courts uniformly have held that ambiguous statutes and treaties should be construed in favor of Indians only when the statute or treaty "contains language which can reasonably be construed to confer income (tax) exemptions." *Holt v. Commissioner*, 364 F.2d 38, 40 (8th Cir. 1966); *see United States v. Anderson*, 625 F.2d 910, 913 (9th Cir. 1980); *Hoptowit*, 709 F.2d at 565. The statute in issue here, the ITJFUDA, is not ambiguous; it applies to *per capita* distributions to members of the Tribe. It contains no language that reasonably could be construed as providing that funds paid to a tribal employee for services rendered are exempt from tax. And, as the District Court noted (Aplt. App. 404), the case law does not support taxpayers' position. Therefore, the District Court correctly held that the salary income in issue was taxable.

II

THE DISTRICT COURT CORRECTLY HELD THAT TAXPAYERS WERE LIABLE FOR THE ACCURACY-RELATED PENALTY

Standard of Review

The district court's determination of the applicability of the penalty imposed by I.R.C. § 6662 is reviewed under the "clearly erroneous" standard. *Van Scoten v. Commissioner*, 439 F.3d 1243, 1259 (10th Cir. 2006).

A. Introduction

1. The I.R.C. § 6662 accuracy-related penalty

Section 6662 of the Internal Revenue Code imposes a 20% accuracy-related penalty on the portion of any underpayment of tax attributable to, *inter alia*, negligence or disregard of rules or regulations. I.R.C. § 6662(a), (b)(1). Congress enacted I.R.C. § 6662 as part of the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721(c)(2), 103 Stat. 2106, 2395–2400, effective for returns due after 1989. Negligence is defined as the "lack of due care or failure to do what a reasonable or ordinarily prudent person would do under the circumstances." *Van Scoten*, 439 F.3d at 1252 (quoting *Anderson*, 62 F.3d at 1271).

No penalty will be imposed under § 6662 if the taxpayer establishes that, with respect to any portion of an underpayment, there was reasonable cause for that portion of the underpayment, and that he acted in good faith with respect to such portion. I.R.C. § 6664(c)(1). These requirements are in the conjunctive; the taxpayer must demonstrate both that he had reasonable cause for the understatement, and that he acted in good faith. *Van Scoten*, 439 F.3d at 1259.

2. The burden of production

As a general rule, the Commissioner's determination is presumed correct, and the taxpayer bears the burden of proving otherwise. Tax Ct. R. 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933). An exception to the general rule is found in I.R.C. § 7491(c), which places on the Government the burden of production with respect to penalties, applicable to "court proceedings arising in connection with examinations commencing after" July 22, 1998. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3001(c), 112 Stat. 685, 727. This case falls within that time frame, and the Government therefore had the burden of coming forward with sufficient evidence to indicate that it was appropriate to impose the penalty. *Higbee v. Commissioner*, 116 T.C. 438, 446 (2001). Taxpayers, however, bear the burden of proving that there was substantial authority, reasonable cause, or similar provisions that would make the penalty inapplicable. *Id.* at 446-447.

3. The District Court correctly sustained the penalty

Here, the material facts were stipulated, and it is undisputed that taxpayers intentionally failed to report on their tax return the $48,057.64 salary paid to taxpayer by the Tribe for his services as Chairman in 2001. Without more, this would justify imposing a penalty for negligence. Taxpayers assert (Br. 24-26) that the District Court erred in not requiring the Government to meet its burden of production under I.R.C. § 7491(c). We submit, however, that the facts as stipulated were sufficient to meet the Government's burden of production. *See, e.g., Allen v. Commissioner*, T.C. Memo 2005-118 (establishing that the income taxpayer received from her tribe was taxable is sufficient to meet Commissioner's burden of production with respect to the § 6662 accuracy-related penalty); *Higbee*, 116 T.C. at 447 (showing that tax return was filed one year after it was due was sufficient to meet Commissioner's burden of production with respect to the penalty for late filing).

Although the District Court opined that it might well find a triable issue of fact as to taxpayers' subjective good faith (Aplt. App. 407-408), there is no basis for concluding that the court committed clear error in concluding that they did not meet their burden of proving that they had reasonable cause for omitting taxpayer's salary from their return.5/ They submitted no evidence showing that they made an attempt to ascertain whether their position was correct; they merely

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5/ That is not to concede that taxpayers made convincing arguments at trial (or on appeal) as to their good faith. For example, they contend (Br. 26) that the Government failed to show that they made "no efforts to determine their tax liability." They then assert (Br. 26) that the record shows that taxpayer did take some steps to ascertain his correct tax liability (although they do not specify what those steps were), and that the Government failed to show that "those were his sole efforts." They also assert (Br. 25) that there was no duty on them to disclose their position to the IRS. But while there may have been no statutory duty to disclose, a factor demonstrating good faith would have been to disclose the salary on the return, along with an explanation of why the taxpayer believed it was not taxable. *Allen*, T.C. Memo 2005-118. *See also* IRS Notice 90-20, 1990-1 C.B. 328, and Rev. Proc. 94-69, 1994-2 C.B. 804, 806. Taxpayer, however, instructed the Tribe's accounting department not to issue him a Form W-2, and not to withhold taxes from his compensation. (Aplt. App. 28.) This conduct, even if not affirmatively evidencing bad faith, undercuts the existence of good faith, because it obviously decreases the likelihood that the IRS will learn of the omitted income and be able to determine whether it is taxable. *See Jombo v. Commissioner*, 84 T.C.M. (CCH) 496, T.C. Memo. 2002-273, *aff'd*, 398 F.3d 661 (D.C. Cir. 2005) (no § 6662 penalty imposed where taxpayer disclosed his lottery winnings on Form 8275).

decided on their own that they did not owe tax on the income, and omitted it from their return. (Aplt. App. 28.) They provided no evidence that they sought advice from any tax, accounting, or legal professionals, despite the fact that they had no particular expertise in this area.

In addition, taxpayers did not have reasonable cause because there was no substantial authority for their position that the salary was not taxable. As discussed, *supra*, the overwhelming weight of authority is against their position; there is nothing remotely on point that supports the tax exemption they claimed. And taxpayers' claimed reliance (Br. 26-29) on the 1983 Plan does not make their position reasonable. The 1983 Plan is not a statute or treaty, even though it was approved by Congress. Further, neither the language of the 1983 Plan nor the ITJFUDA, the statute pursuant to which the 1983 Plan was promulgated, explicitly provides for the tax exemption that taxpayers here claim. The law is clear that, "[a]bsent a definitely expressed exemption, Indians, like all other United States citizens, are subject to federal taxation." *Cook v. United States*, 86 F.3d at 1097. Taxpayers do not address the fact that every court to consider the issue of taxation of salary payments to tribal officers or employees has found these payments to be taxable. Taxpayers' position was not reasonable, was not based on substantial authority, and was not what a reasonable and prudent person would have done.

CONCLUSION

For the foregoing reasons, the District Court's judgment should be affirmed.

STATEMENT REGARDING ORAL ARGUMENT

Counsel for the United States believe that oral argument may be helpful to the Court in its disposition of this case.

Respectfully submitted,

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/s/

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AUGUST 2008

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CERTIFICATE OF SERVICE

It is hereby certified that the original and seven copies of this brief were mailed to the Clerk by FedEx on the 5th day of August, 2008, for next-business-day delivery, and that service of this brief was made on counsel for the appellants on the 5th day of August, 2004, by sending him one paper copy by FedEx, for next-business-day delivery, in an envelope properly addressed to him as follows:

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It is further certified that this brief has been submitted in native PDF format by e-mail to esubmission@ca10.uscourts.gov; that all required privacy redactions have been made and, with the exception of those redactions, every document submitted in native PDF format is an exact copy of the written document filed with the Clerk; and that the digital submission has been scanned for viruses with the eTrust Antivirus program (copyright 2003) and, according to the program, is free of viruses.

s/ ______________________________
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