

TAM 8349005, 1983 WL 201424 (IRS TAM)

Internal Revenue Service (I.R.S.)

Technical Advice Memorandum

August 17, 1983

Section 61 -- Gross Income v. Not Gross Income
61.00-00 Gross Income v. Not Gross Income
61.32-00 Indians

Legend:

Taxpayers = * * *

Tribe = * * *

Reservation = * * *

Taxpayers' names: * * *

Taxpayers' address: * * *

Taxpayers' identification nos.: * * *

Years involved: * * *

Date of Conference: * * *

ISSUE:

Whether Taxpayers' Indian-related income can appropriately be allocated between income that is directly derived from the land and income that is derived from improvements and, if so, what method should be utilized in applying the allocation?

FACTS:

Taxpayers, husband and wife, reside on Reservation. The husband is a member of Tribe and, since * * * has held a possessory interest in land located on Reservation. Taxpayers operate a campground and recreation area on the possessory holding.

Taxpayers receive income from the rental of camping sites, fees from a riding stable, fees from a recreational waterslide, and from concession sales. Taxpayers' income from their business is generated primarily by factors other than the land itself. Capital improvements and depreciable assets are utilized in the Taxpayers' business. The depreciation schedule for * * * includes assets costing \$ * * *, of which \$ * * * relates to riding stable income; \$ * * * relates to water slide income; \$ * * * relates to camping income, and the remaining \$ * * * relates to no specific income or is undetermined.

Income is also derived from rental of a small store building to third parties. The books and records for each component of Taxpayers' recreation area are separately maintained, but all income is reported together for Taxpayers' convenience.

Improvements and amenities have been made by Taxpayers to the campground area. These include roadways, electrical and water connections, picnic tables, and sanitary and shower facilities.

Taxpayers' campground is located in one of the most scenic parts of Reservation and has a stream flowing through it which provides an area for swimming, fishing, and tubing. The stream also provides water for the waterslide, which is a manmade structure.

Taxpayers' business is generated primarily from tourists visiting a nearby national park and the Reservation, with some campers staying in order to enjoy the facilities and natural resources of the campgrounds.

APPLICABLE LAW AND RATIONALE:

It is well settled that, unless some provision of a statute or treaty expressly confers an exemption, Indians are subject to the federal income tax to the same extent as any other U.S. citizen. [Squire v. Capoeman, 351 U.S. 1 \(1956\), 1956-1 C.B. 605](#). The Supreme Court of the United States has interpreted the General Allotment Act of 1887 to exempt from federal income tax certain Indian-related income that was "derived directly" from the land. [Capoeman, 351 U.S. at 9](#).

The Capoeman decision established a strict rule regarding the exemption of Indian-related income that is directly derived from the land. In Capoeman the Supreme Court considered whether the sale, on behalf of a noncompetent Indian, by the U.S. Government of standing timber on allotted Indian lands was subject to capital gains tax. In distinguishing the Capoeman situation from one in which Indian-related income was derived from investment of surplus income from the land, the Supreme Court emphasized that the harvesting of the timber lessened the value of the respondent-Indian's allotment. The term "directly derived" was thus narrowly drawn. On this basis, the Supreme Court held that the proceeds from the sale were not subject to federal income tax.

In [Rev. Rul. 67-284, 1967-2 C.B. 55](#), modified by [Rev. Rul. 74-13, 1974- 1 C.B. 14](#), the Internal Revenue Service set forth its position concerning the federal income tax treatment of Indian-related income. The rev. rul. states that income derived directly by a noncompetent Indian from allotted and restricted land held under acts or treaties containing an exemption provision similar to the General Allotment Act is not subject to federal income tax. Included within the list of exempt income items are rentals (including crop rentals), royalties, proceeds from the sale of natural resources of the land, income from the sale of crops upon the land, and from the use of land for grazing purposes, and income from the sale or exchange of cattle or other livestock raised on the land.

In [Critzler v. United States, 597 F.2d 708 \(Ct.Cl.1979\)](#), cert. denied [444 U.S. 920 \(1979\)](#), the court considered whether Indian-related income received from the operation of businesses and building leases on a possessory holding was exempt from federal income tax. In Critzler the taxpayer operated a motel, restaurant, and gift shop, and also received income from building rentals. The court concluded that income received by the taxpayer from the operation of the businesses described above is not income directly derived from the land and is not immune from federal income tax simply because the business and buildings are physically located on tax exempt reservation land.

The court recognized, however, that the land underlying the building was necessary to the operation of those businesses. Although the court never reached the allocation issue it was suggested that an allocation may be appropriate in certain circumstances. [Critzler, 597 F.2d at 714](#).

The allocation problem arises where Indian-related income is attributable to an aggregate of factors such as services, improvements and land. The Service has previously recognized the composite nature of certain Indian-related income items and has considered the possibility of an allocation between income that is directly derived from the land and income that is derived from non-land factors. An allocation approach was, in fact, adopted in [Rev. Rul. 60-377, 1960-2 C.B. 13](#), revoked by [Rev. Rul. 62-16, 1962-1 C.B. 7](#), which involved the taxability of proceeds from the sale of livestock by an Indian. The rev. rul. concluded that the proceeds were exempt from taxation in an amount equal to the grazing fees that could have been obtained had the land been leased for grazing purposes. However, [Rev. Rul. 62-16](#) revoked [Rev. Rul. 60-377](#) and allowed a complete exemption. [Rev. Rul. 62-16](#) reasoned that the formula set forth in [Rev. Rul. 60-377](#) proved too difficult to implement.

It is recognized, then, that there is nothing inherently incorrect in permitting an Indian to divide his income into exempt and nonexempt portions given the proper facts and circumstances. However, an allocation approach must be utilized with a considerable degree of restraint, particularly in situations in which an allocation would require a difficult assignment of relative values to the different components that generate the income in question.

The practical and equitable considerations that support the position set forth in the

foregoing paragraph are manifest. The Service's prior attempt at allocation in the case of the proceeds from livestock sales proved too administratively difficult to implement. Thus, despite the presence of such non-land factors as labor and the use of equipment, the Service revoked its allocation approach and allowed a total exemption from taxation. See [Rev. Rul. 62-16](#). Similarly, the Service declined to adopt an allocation formula and allowed a complete exemption with respect to proceeds from the sale of crops, despite the fact that labor and the use of equipment contributed to such income. See [Rev. Rul. 56-342, 1956-2 C.B. 20](#), amplified by [Rev. Rul. 62-16](#). Thus, the position of the Service has been to allow a total exemption when Indian-related income is primarily attributable to land factors. It is consistent then to allow no exemption of Indian-related income when such income is primarily attributable to factors other than the land.

Accordingly, when presented with facts similar to those set forth in Critzer, where the income was derived primarily from improvements, the Service position is that none of the income is exempt even though the improvements are located on tax-exempt Indian land. In the Critzer situation, the income is clearly primarily non-land based income.

However, the present case sets forth a factual situation that is appropriate for application of an allocation formula. Here, Taxpayers' businesses represent essentially separate operations. Income from campsite rentals is "income directly derived from the land" within the meaning of Capoeman, and is the type of exempt rental income contemplated in [Rev. Rul. 67-284](#). Although certain improvements are used directly in connection with the campsite (electrical and water connections, and showers), and the presence of the waterslide and riding stable may be instrumental in attracting campers to the campground, these improvements are merely incidental to the generation of the campsite rental income.

Further, as discussed above, the Service's revocation of the allocation approach set forth in [Rev. Rul. 60-377](#), was based primarily on the fact that the approach had proved too administratively difficult to implement. In the present case, no such administrative difficulty arises because Taxpayers, by separately stating the campsite rental income, are able to provide the information necessary upon which an allocation may be based.

CONCLUSION:

Taxpayers' Indian-related income may be divided into taxable and nontaxable categories, with the waterslide and riding stable income falling into the taxable category, and the campsite rental income falling into the nontaxable category.

This document may not be used or cited as precedent. [Section 6110\(j\)\(3\) of the Internal Revenue Code](#).

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