

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 17308
[Redacted]	)	
	)	DECISION
Petitioner.	)	
_____	)	

On November 13, 2002, the Tax Discovery Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted]. (taxpayer), asserting additional income taxes, late-filing penalty, and interest in the amount of \$44,482 for the 1997 through 2000 taxable years. On January 8, 2003, the taxpayer filed a timely appeal and petition for redetermination. An informal conference was held via telephone on July 8, 2003. The Tax Commission, having reviewed the file, hereby issues its final decision.

This is a corporate income tax case involving an Idaho corporation that operates a [Redacted]smoke shop[Redacted] within the boundaries of the [Redacted] Indian reservation and that is wholly owned by an enrolled member of the [Redacted] Indian tribe. The corporation sells tobacco products and “other sundry items” at retail and does not limit its customers to only members of the [Redacted] Tribe. The question presented in this administrative appeal is whether the State of Idaho can tax the income of this Idaho corporation. The taxpayer asserts that since the corporation is wholly owned by an enrolled member of the [Redacted] Tribe, and since the business is conducted wholly within the boundaries of the [Redacted] Tribe, it is exempt from state income taxation. The audit staff, on the other hand, asserts that since the corporation is not itself a member of the [Redacted] Tribe, it is not immune from the Idaho corporate income tax.

This case presents a question of first impression in Idaho. Is a corporation, incorporated under the laws of Idaho and doing business exclusively within this state, nonetheless exempt from the Idaho corporate income tax because it is owned by a tribal member and conducts its business within the boundaries of a federally recognized Indian reservation? Neither the Idaho Supreme Court nor the United States Supreme Court has yet to specifically answer this question. However, the U.S. Supreme Court has set out the analytical framework under which the Commission will consider this question. Simply stated, the U.S. Supreme Court requires the following two-step analysis:

- If the legal incidence of the tax falls upon an Indian tribe or tribal member for sales or business activity taking place within Indian country, the tax is unenforceable unless there is clear Congressional authorization for the tax. McClanahan v. Arizona State Tax Commission, 411 U.S. 164 (1973); Oklahoma Tax Com'n v. Chickasaw Nation, 515 U.S. 450, 459 (1995).
- If the legal incidence of the tax falls upon non-Indians, no categorical bar prevents enforcement of the tax. Rather, a balancing test is employed. If the balance of federal, state, and tribal interests favor the state, and federal law is not to the contrary, the state tax is not preempted. However, if the balancing of interests does not favor the state, the tax is unenforceable. Chickasaw Nation, 515 U.S. at 459.

It is undisputed that the business activities of [Redacted] place wholly within the [Redacted] Reservation. Thus, the first issue to be addressed in this protest is whether the Idaho tax falls upon the [Redacted] Tribe or an enrolled member of that Tribe. If so, the tax is preempted absent clear congressional authorization. If not, then we must apply the balancing of interests test.

[Redacted] was incorporated in late 1996. Since that time the corporation has filed federal corporate income tax returns. It is significant to note that during the years at issue in this dispute (1997 through 2000) the corporation did not elect to be taxed under Subchapter S of the

Internal Revenue Code. If it had, then the legal incidence of any Idaho income tax would have been passed through and imposed at the shareholder level. See Idaho Code § 63-3030(a)(4) (“A corporation which is reporting as an S corporation to the federal government must report to the state of Idaho as an S corporation . . . .”) and I.R.C. § 1366(a) (income of an S corporation is passed through and taxed at the shareholder level). Since the shareholder in this case is an enrolled member of the [Redacted], the Idaho tax would have been preempted absent clear congressional authority permitting the tax. However, because the corporation did not elect to be taxed under Subchapter S of the Internal Revenue Code, the legal incidence of the tax is on the corporation and not on the shareholder. See Idaho Code § 63-3025 (“a tax is hereby imposed on the Idaho taxable income of a corporation which transacts or is authorized to transact business in this state . . . .”).

The taxpayer’s representative argues that since the corporation is wholly owned by a member of the [Redacted] Tribe it enjoys the same immunity as the tribal member / shareholder. In support of this proposition, the representative points to J&M Smokehouse, Inc. v. State, Dept. of Revenue, CCH Wash.St.Tax Rep., ¶202-127 (1996 WL 390850) (Wash. Bd. Tx. App. 1996), which is an administrative decision issued by the Washington Board of Tax Appeals. That case involved a Washington corporation, J&M Smokehouse, which was owned and managed by a member of the Squaxin Island Indian Tribe. The corporation purchased and processed fish that was caught by members of the Tribe at the Tribe’s “usual and accustomed fishing grounds pursuant to fishing rights reserved” by the Treaty of Medicine Creek. The issue presented was “whether a state-chartered corporation wholly owned and managed by a member of the Squaxin Island Indian Tribe . . . is exempt from business and occupation (B&O) taxation with respect to gross receipts derived from the sale of cured salmon caught by the owner and other tribal

members exercising their treaty fishing rights under the Treaty of Medicine Creek . . . , 10 Stat. 1132 (1954).” Id. The Board found that since “the specific language of the Treaty precludes the imposition of the B&O tax under the facts of this case,” the B&O tax assessment was preempted. Id.

Because J&M Smokehouse is a well-written and well-reasoned decision and because it sets out in a very cogent fashion the argument that [Redacted] is advancing in this administrative appeal, we have no hesitation in quoting at length from that decision:

The [Washington] Department [of Revenue] next argues that J&M is liable for the B&O tax in any event because it is a state-chartered corporation, and not an individual Indian member of the Tribe. As far as we can determine, this is an issue of first impression in Washington. The Department notes that a corporation is a separate entity from its shareholders, and argues there is no authority for exempting a corporation from taxation based solely on the identity of its shareholders. The Department cites to a previous Determination [of the Washington Board of Tax Appeals] in which it is stated:

[T]he state’s position has been that Indians who choose to avail themselves of the benefits of state law abandon their right to be exempt from privileges granted to them as Indian persons under 192. In Det. No. 88-324 . . . the Department held that

[w]e note that the Indian shareholders operate in the corporate form by choice. The corporate form is authorized by the state and confers certain benefits not available to sole proprietorships or partnerships. Choosing that form of business organization in this situation also causes the individual owners of the corporation to lose any tax immunity they may have had as Indians with respect to the business. It is a consequence of their own election to use the corporate form of organization.

The Department’s position is understandable. It is supported in the highly regarded treatise, Felix S. Cohen, *Handbook of Federal Indian Law* (1982 ed.), wherein the authors state, at 355-56: “State chartered

corporations, being fictional persons created by the states, should be treated as non-Indians even if owned by Indians.” But the *Handbook’s* authors note, at 356 n.73: “The one reported case on this point is to the contrary and seems wrong in its rationale. *Eastern Navajo Indus., Inc. v. Bureau of Revenue*, 89 N.M. 369, 552 P.2d 805 (Ct. App.) (Remaining citations omitted.)

We agree with the Department that, as a general rule, a corporation is a separate legal entity from its shareholders and is not exempt from taxation because of the identity of its shareholders. We also agree that the corporate form of business is authorized by the state, and confers certain benefits not available to individuals or partnerships. We do not agree, however, that the choice of a corporate form of business necessarily results in a tribe or an individual tribal member losing tribal treaty rights.

First, it is not clear that the choice of a corporate form of business causes the loss of state tax exemptions generally applicable to Indian tribes. In *Mescalero Apache Tribe*, [411 U.S. 145 (1973)], the tribe conducted its off-reservation business through a corporation chartered under the Indian Reorganization Act. The Court, at n.13, stated: “In any event, the question of tax immunity cannot be made to turn on the particular form in which the Tribe chooses to conduct its business.” On the other hand, the IRS has taken the position that although a tribal-chartered corporation is exempt from federal income tax with respect to operating a commercial business, the tribe is not exempt when it operates a business through an ordinary state-chartered corporation. Rev. Rul. 94-16, 1994-1 C.B. 19 (1994). The IRS’s analysis – in its entirety – is as follows:

However, a corporation organized by an Indian tribe under state law is not the same as an Indian tribal corporation organized under section 17 of the [Indian Reorganization Act] and does not share the same tax status as the Indian tribe for federal income tax purposes. Generally, the choice of corporate form will not be ignored. *See Moline Properties v. Commissioner*, 319 U.S. 436 (1943).

At best, the above authorities are inconclusive as to the state tax status of an individual Indian conducting business in the corporate form. Most deal with the tax status of an *Indian tribe* rather than an individual Indian. Nevertheless, the pronouncement of the U.S. Supreme Court in *Mescalero Apache Tribe* gives us serious pause when considering the issue of an individual Indian’s immunity from state taxation. If the choice of a tribe to do business in a corporate form is irrelevant (at least in the mind of the U.S. Supreme Court) to its state tax immunity, logic would seem to compel the conclusion the choice is also irrelevant to the question

of an individual Indian's tax immunity. We are aware of no U.S. Supreme Court authority which distinguishes between the state tax immunity of a tribe and the state tax immunity of an individual tribal member.

Second, and conceding for argument's sake that logic is not always the preferred basis for analyzing issues involving federal or state taxation of Indians, the issue in this appeal involves the question of the exercise of a treaty right, and not the operation of an ordinary commercial enterprise. The precise question is whether an individual tribal member relinquishes his or her tribal treaty rights by choosing to exercise them through the vehicle of a state-chartered corporation. J&M argues this question turns on tribal—not state—law. In other words, J&M argues it is only the tribe which has the power to decide in what legal form its individual members can exercise the tribe's treaty rights. Although there is much to commend J&M's position, at least insofar as the question does not involve non-tribal members or any legitimate regulatory concerns of the state relating to conservation of the fishery resources. We find it unnecessary to rest our decision on the power of the tribe to control its members.

Construing the language of the Treaty in the sense it would be naturally understood by the Indian signatories, it defies common sense to find they understood that fishing rights would be lost if they chose to exercise them through the vehicle of a state-chartered corporation. It is doubtful the Indian signatories even knew that state-chartered corporations existed, let alone that their reserved fishing rights were good only so long as they were exercised by tribal members acting as sole proprietorships. It would be a cruel hoax on the Indian signatories and their descendants to find at this late date that the United States intended to limit the tribe's reserved fishing rights so that tribal members could exercise those rights only in their individual capacity. There is nothing in the language of the Treaty, the circumstances surrounding its negotiation, or the subsequent conduct of the parties which compels such a conclusion. We see no reason to adopt a construction of the Treaty which would deny to the tribe and its members the benefit of modern-day business methods commonly used by non-Indian fishers. Such a holding would unnecessarily impede the full exercise of the tribe's bargained-for commercial fishing rights. One might just as well argue the state could impose, for example, a discriminatory prohibition on the tribe's use of internal combustion engines or electronic fish finders on the grounds that such devices were not employed by the tribe in 1854.

We therefore find as a matter of "fair construction of the treaty" . . . that the language of the Treaty prohibits the imposition of a state tax on the privilege of exercising rights reserved to the tribe, where the rights are exercised by a member of the tribe acting in the legal form of a state-chartered corporation wholly owned and managed by such member.

J&M Smokehouse, Inc. (footnotes omitted) (underline added for emphasis).

The Washington Board of Tax Appeals makes two important points. First, the specific issue of whether a state-chartered corporation is clothed with the same immunity as its tribal member shareholder is a close question with relevant authority pointing both directions. Second, while recognizing the specific question raised in this protest – whether a state-chartered corporation is clothed with the same immunity as its tribal member shareholder – the Board chose to decide the case on narrower grounds. The Board based its decision on the language of the Treaty of Medicine Creek, not on the theory that the corporation was exempt because it was owned by a member of the Squaxin Island Indian Tribe.

In the present case, [Redacted] has not pointed to a specific treaty that might control the outcome of this protest. As a result, the Commission does not view the decision in J&M Smokehouse, Inc. as persuasive authority for the assertion that [Redacted] is exempt from the Idaho corporate income tax. Furthermore, the Commission does not read footnote 13 of Mescalero Apache Tribe v. Jones as compelling the result advanced by [Redacted]. The issue in Mescalero was whether Mescalero Apache Tribe was liable for New Mexico gross receipts tax and use tax on materials purchased and used as part of the Tribe’s off-reservation ski resort business enterprise. Because the Tribe’s business enterprise was conducted off the reservation, there was no *per se* preemption of the New Mexico taxes. Instead, the U.S. Supreme Court was asked to determine if the taxes were preempted under the provisions of the Indian Reorganization Act of 1934. In making that determination, the Court first discussed the purpose of the federal Act. “The intent and purpose of the Reorganization Act was to rehabilitate the Indian’s economic life and to give him a chance to develop the initiative destroyed by a century of oppression and paternalism.” Mescalero at 152 (internal quotations omitted). To achieve this

purpose, “tribes were encouraged to revitalize their self-government through the adoption of constitutions and bylaws and through the creation of chartered corporations, with power to conduct the business and economic affairs of the tribe.” Id. at 151. See also Robles v. Shoshone-Bannock Tribes, 125 Idaho 852, 853 n.1, 876 P.2d 134, 135 n.1 (1994) (explaining the distinction between a tribal government authorized by section 16 of the Indian Reorganization Act and a tribal corporation authorized by section 17 of that Act.). The federal law specifically authorized the creation of Indian chartered corporations. In reviewing the specific facts of the Mescalero Apache’s off-reservation ski resort enterprise, the Supreme Court noted that the record did not reflect whether the enterprise was an Indian chartered corporation or a state chartered corporation. Id. at 157, n.13. It was within this context that the Court stated that “[i]n any event, the question of tax immunity cannot be made to turn on the particular form in which the Tribe chooses to conduct its business.” Id.

Read in context, it seems evident that footnote 13 of Mescalero establishes that the question of tax immunity under the Indian Reorganization Act of 1934 cannot be made to turn on whether the Tribe chooses to conduct its business as an Indian chartered corporation or as a state chartered corporation. The Washington Board of Tax Appeals, in J&M Smokehouse, failed to adequately consider the context of this footnote when it declared that “the pronouncement of the U.S. Supreme Court in *Mescalero Apache Tribe* gives us serious pause.” To read that footnote as setting out a *per se* rule that a state-chartered corporation is always clothed with the same tax immunity enjoyed by its tribe or tribal member shareholders would be inconsistent with the express holding in the Mescalero case that the Indian Reorganization Act does not “imply an expansive immunity from ordinary income taxes that businesses throughout the State are subject to.” Id. at 157. Simply stated, Mescalero involved the interpretation of the Indian Reorganization

Act of 1934. It does not stand for the proposition that a state-chartered corporation is clothed with the same immunity as its Tribe or tribal member shareholders outside of the specific application of that Act.

In the final analysis, the present case is distinguishable from the J&M Smokehouse case and the Mescalero case in that this case does not involve a federal law or Indian treaty that potentially bars the application of the Idaho corporate income tax. Absent an express or implied preemption based on a federal law or Indian treaty, there is no legal reason why an Idaho corporation should be exempt from the income tax laws of this state based on the fact that the shareholder would be exempt if the incidence of the tax fell directly upon him. Under Idaho law, a corporation is treated as a separate legal entity from its owners. Jordan v. Hunter, 124 Idaho 899, 905, 865 P.2d 990, 996 (Ct.App. 1993) (“Every corporation is to be regarded as a separate legal entity. Furthermore, ‘where an entity chooses to incorporate under the laws of this State and to thereby receive the benefits and privileges extended to corporations, it cannot, when convenient, ask the court to ignore its corporate status and extend to it the advantages to which an individual person is commonly entitled.’”) (*quoting* Kyle v. Beco Corp., 109 Idaho 267, 272, 707 P.2d 378, 383 (1985)). Moreover, the Idaho corporate income tax is clearly imposed upon the corporation. Idaho Code § 63-3025. Therefore, the legal incidence of the tax falls upon a non-Indian. As a result, the corporation is not entitled to the *per se* preemption that might otherwise apply to an Indian tribe or tribal member.

There are certain benefits and advantages to conducting business in the corporate form. The owner of [Redacted] sought to avail the business of these advantages when he decided to incorporate the business. With the choice to incorporate and to accept the benefits and advantages of corporation status, the owner of [Redacted] must also assume the consequences,

including the tax consequences, which flow from that decision. As pointed out by the U.S. Supreme Court in Moline Properties v. Commissioner of Internal Revenue, 319 U.S. 436 (1943):

The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. . . . The choice of the advantages of incorporation to do business . . . require[s] acceptance of the tax disadvantages.

Id. at 438 – 439. (Footnotes omitted).

Moline Properties and Jordan v. Hunter clearly stand for the proposition that when an entity such as [Redacted] accepts the benefits and privileges extended to corporations, that entity cannot, when convenient, ask to have its corporate status disregarded. Under Idaho law, all corporations doing business in this state, regardless of who owns them, are required to pay Idaho corporate income tax on their Idaho taxable income. This is a policy decision made by the Idaho legislature. Absent clear federal preemption, the Tax Commission has no alternative but to enforce the Idaho tax laws as written; and based on the arguments and facts presented in this administrative protest, the Tax Commission cannot say that there is clear federal preemption that applies here.

To summarize, the Tax Commission hereby rules that where there is no federal law or Indian treaty that potentially preempts the tax laws of this state, a state-chartered corporation will be treated as a separate legal entity from its tribal member shareholder(s). Thus, any state tax imposed directly on that corporation is not *per se* preempted. Instead, the validity of the tax must be measured under the “balancing of interests” rubric articulated by the U.S. Supreme Court in Chickasaw Nation. We now turn to that “balancing of interests” test.

As noted above, the Supreme Court, in Chickasaw Nation, held that “if the legal incidence of the [challenged] tax rests on non-Indians, no categorical bar prevents enforcement of the tax.” Oklahoma Tax Com’n v. Chickasaw Nation, 515 U.S. 450, 459 (1995). Rather, “if the balance of federal, state, and tribal interests favor the State, and federal law is not to the contrary, the State may impose its levy.” Id. In the present case, there is no question that the State of Idaho has a legitimate governmental interest in raising revenue through a tax on corporations conducting business within this state. While it is true that this interest is “strongest when the tax is directed at off-reservation value and when the taxpayer is the recipient of state services, Washington v. Confederated Tribes of Colville Reservation, 447 U.S. 134, 156 – 157 (1980), there is nonetheless a strong state interest in taxing all corporations conducting business within this state regardless of whether the corporation happens to be operating within the boundaries of an Indian Reservation. Idaho law allows for the formation of Idaho-chartered corporations and for the ability of foreign corporations to conduct business within this state. This, in turn, permits business owners to take advantage of the benefits associated with the corporate form such as limited liability, easy transferability of ownership, and perpetual life. In addition, taxes paid by these corporations help finance the various state programs that help maintain a civilized and orderly society and foster a favorable economic climate in which these corporations are able to profit.

While there is an unmistakable state interest at stake in this case, the federal and tribal interests are not so clear-cut. It does not appear that [Redacted] sells exclusively to tribal members or that its markets and sales products are manufactured by the Tribe. In addition, there is nothing in the record to establish that [Redacted] pays any taxes or fees to the Tribe in return for the privilege of conducting its business within the [Redacted] Indian Reservation. The letter of

protest filed by [Redacted] states that it is “licensed and regulated by the [Redacted] Tribe of Indians.” Letter of protest, p.3. However, the Commission has not been provided any details relating to the scope of that tribal regulation. Absent some evidence to the contrary, the Commission fails to see how the Idaho corporate income tax, as applied in this case, infringes in any way on the [Redacted] Tribe’s powers of self-governance or its ability to regulate the activities of corporations or other businesses operating within the bounds of the reservation.

Based on the record currently before the Commission, all that is certain is that [Redacted] employs members of the [Redacted] Tribe and it provides for the livelihood of its sole shareholder who is a member of the Tribe. But these considerations alone are not enough to overcome the state’s interests in taxing the income of this Idaho-chartered corporation. As a result, the Commission finds that the balancing of state, federal, and tribal interests weighs in favor of the state.

[Redacted] has raised a number of other arguments in its letter of protest. See letter of protest, pp. 4 – 5. Most of these arguments were either based on factual allegations that are not supported by the record, or were premised on the taxpayer’s contention that it is a member of the [Redacted] Tribe or is otherwise clothed with the powers, privileges and immunities of its tribal member shareholder. Given the lack of factual support, and given the Commission’s determination above that [Redacted] is a separate legal entity, the Commission hereby rejects those additional arguments. However, the Commission does agree that the 25% non-filer penalty should be abated.

WHEREFORE, the Notice of Deficiency Determination dated November 13, 2002, is hereby MODIFIED in accordance with the provisions of this decision, and as so MODIFIED is APPROVED, AFFIRMED AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following taxes, penalty and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INEREST</u>	<u>TOTAL</u>
1997	\$3,868	0	\$1,593	\$ 5,461
1998	9,227	0	3,090	12,317
1999	9,837	0	2,579	12,416
2000	6,990	0	1,273	<u>8,263</u>
TOTAL AMOUNT DUE				<u>\$38,457</u>

Interest is calculated through January 31, 2004, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2003, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.

[Redacted]