

When is Tribal Farm and Ranch Income Exempt from Federal Taxes?*

*Ruby Ward, Agricultural Entrepreneurship Specialist
Department of Applied Economics, Utah State University*

*JC Hobbs, Assistant Extension Specialist
Department of Agriculture Economics, Oklahoma State University*

*Trent Teegerstrom, Associate Director for Tribal Extension Programs and Ag Economics
Extension Specialist
Agriculture and Resource Economics, University of Arizona*

*Adam J. Kantrovich, Extension Specialist of Agribusiness and Director of the Clemson Tax
School
Clemson Tax School, Clemson University*

Introduction

There are some conditions that will allow income from farming and ranching to be exempt from federal income and self-employment taxes for farming on trust property. However, not all tribal members will meet those conditions. This article will lay out the provisions in the Internal Revenue Service (IRS) and other sources that provide the guidance and authority for the exemption of income from federal taxation. Not all situations will be addressed, and all questions cannot be answered.

* This material is based upon work supported by the U.S. Department of Agriculture, under agreement number FSA21CPT0012032. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Agriculture. In addition, any reference to specific brands or types of products or services does not constitute or imply an endorsement by the U.S. Department of Agriculture for those products or services.

It is important to understand the authority behind this information. In 2006, the IRS released Revenue Ruling 2006-20 which states: *“This revenue ruling emphasizes to taxpayers, promoters, and return preparers that there is no right to exemption from federal income tax for Native Americans under an unspecified “Native American Treaty.” Any return position based on an unspecified “Native American Treaty” has no merit and is frivolous. As a general rule, Native Americans are subject to federal income tax just like every other American.”*

If a tax return is filed and the IRS determines it is not exempt, they will assess the tax that should have been paid plus any interest and penalties. Therefore, it is important to accurately determine and cite the source where the guidance exists for the tax position that the taxpayer is taking regarding the tax exempt status of the income.

Revenue Ruling 67-284 states: *“Two basic categories of income are not subject to Federal income tax, to wit, where a treaty, agreement or act of Congress expressly provides that income is not subject to tax, and where income is derived directly from restricted allotted land held under [certain] circumstances.”* The circumstances are further described in the **Squire v. Capoeman, 351 U.S. 1 (1956)** Supreme Court case.

Revenue Ruling 67-284 goes on to state,

“It is thus the position of the Service that income derived directly by a noncompetent Indian from allotted and restricted land held under the General Allotment Act or derived directly from land held under acts or treaties containing an exception provision similar to the General Allotment Act is not subject to the Federal income tax. See Revenue Ruling 59-349, Cumulative Bulletin 1959-2, 16, and Revenue Ruling 63-244, Cumulative Bulletin 1963-2, 21.

The Service will therefore recognize the exempt status of income received by an enrolled member of an Indian tribe where each of the following tests are met:

- *(1) The land in question is held in trust by the United States Government;*
- *(2) such land is restricted and allotted and is held for an individual noncompetent Indian, and not for a tribe;*
- *(3) the income is “derived directly” from the land;*
- *(4) the statute, treaty or other authority involved evinces congressional intent that the allotment be used as a means of protecting the Indian until such time as he becomes competent; and*
- *(5) the authority in question contains language indicating clear congressional intent that the land, until conveyed in fee simple to the allottee, is not to be subject to taxation.*

If one or more of these five tests is not met, and if the income is not otherwise exempt by law, it is subject to Federal income taxation.”

Squire v. Capoeman, 351 U.S. 1 (1956) determined that the “The General Allotment (Dawes) Act” of 1887 which provided for tribal lands to be allotted to individual Indians in trust for a period of years, after which the lands were to be conveyed to the allottees in fee “free of all charge or encumbrance whatsoever.” (25 U.S.C.A. Par 348) satisfied the tests above. There were three Revenue Rulings published by the IRS that clarified the types of income which were determined to be derived from the land.

- Rents and royalties as well as income from sale of crops or minerals. (**Rev. Rul. 56-342, 1956-2 C. B. 20**)
- Gains from the sale of livestock raised and grazed on allotted trust land (**Rev. Rul. 62-16, 1962-1 C. B. 7.**)
- Payments by USDA for “*conservation of soil and water resources, the maintenance of reasonable and stable supplies of agricultural commodities, and the protection of farm income*”. (**Rev. Rul. 69-289**).

Income that is Subject to Taxes

Renting from an entity that is exempt. Leasing land from an entity or individual (lessor) who is exempt from paying income tax under one of the provisions discussed above does not make the lessee exempt from taxation. “*Income from a trust allotment rented from another Indian is not exempt. Revenue Ruling 57- 523, Cumulative Bulletin 1957-2, 51.*” (Rev. Rul. 67-284)

For example, Brian owns individual allotment land and leases it to Mark to raise hay. The income that Brian receives is exempt (**Rev. Rul. 56-342, 1956-2 C. B. 2**). Mark raises and sells hay. The income that Mark receives is taxable and would be included on his Form 1040 Schedule F: Profit and Loss from Farming.

If Mark leased the land from a Tribal government, even if the Tribal government is exempt for taxation purposes, Mark would still need to include the income and pay taxes on his personal tax return.

Non-Farm Income. The income derived directly from the land only includes the income to the first saleable point. This is the income that would be included on Form 1040 Schedule F: Profit and Loss from Farming. Only the income from the first saleable point of farm and ranch products is included. The income from selling production that has been further processed is included on Form 1040 Schedule C: Business Income.

For example, the sale of wool would be included as part of profit and loss from farming. However, if the wool is used to make a rug, the sale of the rug would be included as business income. The producer would have two businesses. One is raising sheep and the other is making rugs. Normally the individual’s Form 1040 Schedule F: Profit or Loss from Farming would include the value of the

wool as the income and the cost of raising the wool as an expense. On the individual's Form 1040 Schedule C: Business Income the individual would include the sales of the rugs as income and the expenses would include the cost of making the rugs including the value of the wool as reported on the Schedule F. In effect the individual's rug business is buying the wool from their sheep operation. The way to value the wool would be to look at the market rates for wool at the time of the transfer to the rug making business. It is a good practice to keep multiple sources of prices and then take the average of all sources.

If the individual's sheep operation is on land that would meet the criteria in this article for tax exempt, the net income from Form 1040 Schedule F: Profit or Loss from Farming would not be taxed. The Form 1040 Schedule C: Business Income would be subject to tax as described above. The tax-exempt status of the sheep operation would not affect the business income from the rug-making business.

Partial Use of Trust Land. In some circumstances, part of the production or business operation may be on land meeting the criteria to be exempt rather than the entire operation. There is little or no guidance on how to treat this. In general, where there are provisions, but not guidance on exactly how to do it, any reasonable allocation method can be used. Records should be kept of the method used and why. One method that might be used is to proportionately exclude from both income and expenses based on the proportion of individual allotment land versus other land used in the business. A case might also be made for excluding all of the income if an inconsequential amount of non-trust land is used. As always, an individual situation is nuanced and these ideas should be used as educational rather than a definite source for tax treatment of an individual situation. "Facts and circumstances" will prevail in making any determination of tax related decision.

Conclusion

This article presents the authority and provisions for individuals to be exempt from taxation on income derived from trust land. This is for educational purposes and is to provide a summary of the various authority that exists. There are questions and situations that have not been explicitly addressed in revenue rulings, court cases, or internal revenue code. Individuals will need to work with a trusted tax professional that has experience in this area to evaluate specific situations. Where there is no guidance the individual taxpayer and the tax professional will need to use reasonable methods and document the basis for the position taken.

Additional Topics

This fact sheet was written as part of Rural Tax Education a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

- 1099s: <https://ruraltax.org/files-ou/1099s.pdf>
- Self-Employment Tax: http://ruraltax.org/files-ou/2022_SE_Tax.pdf

- Optional Method of Paying Self-Employment Tax: <https://ruraltax.org/filesou/FarmOptionalSETax.pdf>
- How to Choose a Tax Professional: <https://ruraltax.org/files-ou/ChooseTaxProfessional.pdf>
- Tax Estimator Tool: <http://www.ruraltax.org/tax-estimator>

Other Links:

- Inflation Reduction Act Assistance for Distressed Borrowers: <https://www.farmers.gov/inflation-reduction-investments/assistance>
- USDA Tax Information Page: <https://www.farmers.gov/working-with-us/taxes>
- You can learn more about by reading [*Income Tax Guide for Native American Individuals and Sole Proprietors, IRS Publication 5424.*](#)

This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

USDA is an equal opportunity provider, employer, and lender. Rural Tax Education is part of the National Farm Income Tax Extension Committee. The land-grant universities involved in Rural Tax Education are affirmative action/equal opportunity institutions.

