## ***Cross v. Commissioner*, T.C. Memo. 1984-409**

Income earned by Native Americans from business activities conducted on trust land is subject to federal income tax unless explicitly exempted by treaty or statute; the 'directly derived' income exemption under the General Allotment Act does not extend to business profits from activities beyond the direct exploitation of the land itself.

### Summary

Silas V. Cross, an enrolled member of the Puyallup Indian Nation, operated a smokeshop on land held in trust by the United States. The IRS determined that the income from the smokeshop was subject to federal income tax. Cross argued that the income was exempt under the Medicine Creek Treaty of 1854 and the General Allotment Act of 1887, citing the 'directly derived' income exemption established in *Squire v. Capoeman*. The Tax Court held that smokeshop income was taxable because it was not 'directly derived' from the land itself but from business operations, and no treaty or statute explicitly exempted such income. The court distinguished between income from the exploitation of land resources (like timber or minerals) and income from business activities conducted on the land.

### Facts

Petitioner Silas V. Cross was an enrolled member of the Puyallup Indian Nation and the beneficial owner of land held in trust by the United States, originating from a patent issued to his grandfather under the Medicine Creek Treaty of 1854.

Cross operated a smokeshop on 0.62 acres of this trust land, selling cigarettes, tobacco products, and merchandise.

In 1976, Cross earned a net profit of $41,687 from the smokeshop, and his son, Silas A. Cross, earned $1,899 in wages working at the smokeshop.

Neither petitioner reported this income on their federal income tax returns.

The IRS determined deficiencies, asserting that the smokeshop income and wages were subject to federal income tax.

### Procedural History

The case was brought before the United States Tax Court.

It was submitted under Tax Court Rule 122 based on stipulated facts.

### Issue(s)

1. Whether income earned by an enrolled member of the Puyallup Indian Nation

from the operation of a smokeshop on land held in trust by the United States is subject to federal income taxation.
2. Whether the Medicine Creek Treaty of 1854 provides an exemption from federal income tax for income derived from operating a smokeshop on trust land.
3. Whether the General Allotment Act of 1887, specifically the ‘directly derived’ income exemption established in *Squire v. Capoeman*, exempts smokeshop income from federal income tax.

**Holding**

1. Yes, income from the smokeshop is subject to federal income tax because no treaty or act of Congress expressly exempts such income, and the general rule is that income is taxable unless specifically exempted.
2. No, the Medicine Creek Treaty does not provide an implied or express exemption from federal income tax for smokeshop income because it does not address federal income taxation, which did not exist when the treaty was enacted, and its trade restrictions are geographical, not tax-related.
3. No, the ‘directly derived’ income exemption under the General Allotment Act, as interpreted in *Squire v. Capoeman*, does not exempt smokeshop income because this income is not ‘directly derived’ from the land itself but from business operations conducted on the land, unlike income from timber sales or mineral leases which exploit the land’s resources.

**Court’s Reasoning**

The court began by stating the established principle that “the income of Indians is taxable under [Section 61 of the Internal Revenue Code], ‘unless an exemption from taxation can be found in the language of a Treaty or Act of Congress.’” citing *Commissioner v. Walker*, 326 F.2d 261, 263 (9th Cir. 1964).

The court rejected the petitioner’s argument that the Medicine Creek Treaty impliedly reserved the power of taxation to the Puyallup Indian Nation. It found no express language in the treaty restricting the United States’ ability to tax income, especially considering the federal income tax did not exist when the treaty was signed. The court stated, “Any exemption from taxation for Indians must be expressly stated in a treaty or act of Congress.”

Regarding the General Allotment Act and the *Squire v. Capoeman* exemption, the court acknowledged the exemption for income “directly derived” from trust land. However, it distinguished *Squire v. Capoeman*, which involved income from timber sales, a “one-time conversion of the land’s principal resource.” The court emphasized that in *Squire*, “Once logged off, the land is of little value. The land no longer serves the purpose for which it was by treaty set aside…and for which it was allotted to him.”

In contrast, the court reasoned that operating a smokeshop does not diminish the value of the land. “In petitioners’ case, the continued use of the land for retail sales from a smokeshop does not decrease the economic value of the land nor impair the capacity of a competent Indian to ‘go forward * * * with the necessary chance of economic survival.’” The court highlighted that the smokeshop income was generated from business activities – retail sales – not from the direct exploitation of the land itself, unlike farming, ranching, or mineral extraction, which had been previously exempted.

The court also dismissed the petitioner’s alternative argument to exclude the imputed rental value of the land from taxable income, finding it an unsupported and dramatic extension of the “directly derived” exemption. The court quoted *Critzer v. United States*, 220 Ct. Cl. 43, 597 F.2d 708 (1979), noting the absurdity of claiming income from selling stocks and bonds from a phone booth on Indian land as “directly derived” from the land, to illustrate the overreach of the petitioner’s argument.

**Practical Implications**

*Cross v. Commissioner* reinforces the principle that tax exemptions for Native Americans are narrowly construed and must be explicitly stated in treaties or statutes. It clarifies that the “directly derived” income exemption from *Squire v. Capoeman* is limited to income generated from the exploitation of the land’s natural resources, such as timber, farming, ranching, and mineral extraction. It establishes that income from business operations conducted on trust land, like retail sales in a smokeshop, is generally taxable.

This case is crucial for understanding the scope of tax exemptions for Native American income and for advising clients on the taxability of business ventures on trust lands. It highlights that simply operating a business on trust land does not automatically confer a tax exemption. Legal professionals must look for explicit treaty or statutory exemptions and distinguish between income from direct land exploitation and income from business activities when assessing tax liabilities for Native American clients.

Subsequent cases have consistently followed *Cross* in distinguishing between exempt income directly from the land and taxable income from business activities conducted on the land, further solidifying this distinction in federal Indian tax law.

 