

1 Katherine MacDonald
Tax Counsel III
2 Board of Equalization, Appeals Division
450 N Street, MIC: 85
3 PO Box 942879
Sacramento CA 95814
4 Tel: (916) 445-2641
Fax: (916) 324-2618
5

6 Attorney for the Appeals Division

7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
9

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **MERVIN L. GEORGE, SR. AND**) Case No. 443087
13 **LAURA LEE GEORGE¹**)
14 _____)

| | <u>Proposed Assessments²</u> | |
|--------------|---|----------------------------|
| <u>Years</u> | <u>Tax</u> | <u>Penalty³</u> |
| 2002 | \$5,259.00 | \$202.67 |
| 2003 | \$5,733.00 | |
| 2004 | \$6,023.00 | |
| 2005 | \$6,152.00 | |

19 Representing the Parties:

20 For Appellants: Mervin L. George, Sr.
21 Laura Lee George

22 For Franchise Tax Board: Natasha Sherwood Page, Tax Counsel III
23

24 **QUESTION:** Whether California may tax the income of appellants, who are Indians residing on a
25 _____

26 ¹ Appellants reside in Hoopa, California.

27 ² At or prior to the hearing, respondent should provide or be prepared to provide the amount of accrued interest.

28 ³ This is a post-amnesty penalty.

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board review. It does not represent the Board's decision or opinion.

1 reservation and receiving wage income and retirement income.

2 HEARING SUMMARY

3 I. General Background

4 Appellant-husband is an enrolled member of the Hoopa Valley Tribe, which is a federally
5 recognized Tribe. (Appeal Letter, p. 2.) Appellant-wife is an enrolled member of the Karuk Tribe of
6 California. (*Ibid.*) Both reside on the Hoopa Valley Indian Reservation. (Appeal Letter, p. 3 and Resp.
7 Opening Br., p. 1.) Prior to his retirement in 1998, appellant-husband worked for the City of Eureka.
8 (Appeal Letter, p. 3.) State taxes were paid on his income from the City of Eureka while he resided and
9 worked off the reservation. (*Ibid.*) Appellant-wife retired from Humboldt State University (HSU) in
10 2001. State taxes were paid on all income earned from HSU. In 2002, appellant-wife began receiving
11 PERS retirement income from her employment as HSU. Appellant-wife worked for Klamath-Trinity
12 Joint Unified School District (Klamath-Trinity School District) from 2000-2006. (*Ibid.*)

13 Appellant-wife owned rental property that appellants state is on the Hoopa Valley Indian
14 Reservation on Lot 71. (*Ibid.*) During each of the years at issue, appellants received the following
15 income:

| <u>Source</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> |
|---|-------------|-------------|-------------|-------------|
| CalPERS – Appellant-husband | \$15,113.36 | \$15,420.68 | \$15,734.68 | \$16,055.00 |
| CalPERS – Appellant-wife | \$21,005.64 | \$20,820.26 | \$21,103.06 | \$21,828.48 |
| Kalmath-Trinity School District wages – Appellant-wife | \$73,198.44 | \$74,498.31 | \$74,331.51 | \$80,405.76 |

16
17
18
19
20 Appellants filed timely joint California tax returns for each of the years at issue. (Resp.
21 Opening Br., p. 2.) In each of the years at issue, appellants subtracted all of their income on Schedule
22 CA of their California tax returns claiming that it was exempt from tax because appellants were Native
23 Americans living on an Indian reservation. Appellants also subtracted from Schedule CA small amounts
24 of interest income, business losses and rents/royalty income, claiming that they were exempt because
25 they were members of federally recognized tribes living on the Hoopa Reservation. (*Ibid.*)

26 After reviewing the returns, respondent determined that appellants were California
27 residents and did not meet the requirements for their income to be considered non-taxable by California
28 because the income at issue was not reservation-source income and because appellant-wife was not a

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 member of the Hoopa Valley Tribe. (See Notice of Proposed Assessment (NPA) for each year attached
2 to Appeal Letter.) Respondent issued an NPA for each year adjusting appellants' income and proposing
3 tax as follows:⁴

| | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> |
|--------------------------|-------------|-------------|-------------|-------------|
| 4 Revised Taxable Income | \$98,646 | \$110,758 | \$115,412 | \$118,207 |
| 5 Revised Total Tax | \$5,259 | \$5,733 | \$6,023 | \$6,152 |

6
7 (*Ibid.*) Respondent also proposed a post-amnesty penalty of \$202.67 for 2002. (Resp. Opening Br.,
8 exhibit C, p. 1.) Appellants timely protested the proposed assessments.⁵ Respondent affirmed the
9 assessments and issued a NOA for each year.⁶ (Resp. Opening Br., exhibit C.) Appellants filed this
10 timely appeal.

11 II. Applicable Law

12 State Taxation of Indian Income

13 California imposes tax on a resident's entire income from all sources. (Rev. & Tax.
14 Code, § 17041, subd. (a).) A California "resident" includes "every individual who is in this state for
15 other than a temporary or transitory purpose." (Rev. & Tax. Code, § 17014, subd. (a)(1).) The United
16 States Supreme Court has stated that:

17 State sovereignty does not end at a reservation's border. Though tribes are often referred
18 to as sovereign entities, it was long ago that the Court departed from Chief Justice
19 Marshall's view that the laws of [a State] can have no force within reservation
boundaries. Ordinarily, it is now clear, an Indian reservation is considered part of the
territory of the State.

20 (*Nevada v. Hicks* (2001) 533 U.S. 353, 361-362 [internal quotes and cites omitted].) In other words, an
21 individual does not cease to be a California resident merely by living on an Indian reservation that is
22

23
24 ⁴ Each NPA stated that appellants did not meet the requirements to allow their income to be considered exempt because
25 appellant-wife was not a member of the Hoopa Valley Tribe and she did not live on her tribe's reservation. In addition,
respondent explained that the excluded pension income for both appellants was earned from jobs off the reservation and
therefore taxable by California.

26 ⁵ Appellants protested the entire assessment. Thus, it appears to staff that they also contest respondent's imposition of the
27 post-amnesty penalty. As discussed in Staff Comments, below, staff believes that the Board does not have jurisdiction to
review the imposition of this penalty in the circumstances presented here (e.g., where it has not been paid).

28 ⁶ Each of the NOAs also reiterated both the requirements that an Indian must meet in order for income to be considered non-
taxable by California and the reason appellants did not meet these requirements.

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 within California's boundaries. Against this backdrop, California law purports to tax the entire income
2 of any person who resides on an Indian reservation that is within California's borders. It is axiomatic,
3 however, that California cannot confer upon itself the ability to tax income in violation of the U.S.
4 Constitution or federal law.

5 The United States Congress has plenary and exclusive powers over Indian affairs.
6 (*Washington v. Confederated Bands and Tribes of Yakima Indian Nation* (1979) 439 U.S. 463, 470-
7 471.) Throughout the history of our nation, Congress generally has permitted Indians to govern
8 themselves, free from state interference. (*Warren Trading Post Co. v. Arizona Tax Comm'n* (1965) 380
9 U.S. 685, 686-687.) States may exercise jurisdiction within Indian reservations only when expressly
10 allowed to do so by Congress. (*McClanahan v. Arizona State Tax Commission* (1973) 411 U.S. 164,
11 170-171 [*McClanahan*].) Looking to the exclusive authority of Congress and traditional Indian
12 sovereignty, the *McClanahan* Court held that a state may not impose personal income tax on an Indian
13 who lives on her own reservation and whose income derives from reservation sources. (*Id.*, at pp. 173-
14 178.) *McClanahan* has become the seminal case in this area; over 25 years ago the Board asserted that
15 the taxation question turns on whether appellant is a "reservation Indian" within the meaning of
16 *McClanahan*. (*Appeal of Edward T. and Pamela A. Arviso*, 82-SBE-108, June 29, 1982.)

17 The Supreme Court later stated that *McClanahan* created a presumption against state
18 taxing authority which extends beyond the formal boundaries of the reservation, to "Indian country."
19 (*Oklahoma Tax Commission v. Sac & Fox Nation* (1993) 508 U.S. 114.) Congress defined "Indian
20 country" to include reservations, dependent Indian Communities and Indian allotments. (*Id.*; 18 U.S.C.
21 1151. ⁷) It is settled law, however, that a state may tax all the income, including reservation-source
22 income, of an Indian residing within the state and outside of Indian country. (*Oklahoma Tax*
23 *Commission v. Chickasaw Nation* (1995) 515 U.S. 450; *Appeal of Edward T. and Pamela A. Arviso*,
24 *supra.*)

25 The Supreme Court has yet to address a state's ability to impose income tax where the
26 Indian resides on another tribe's reservation. However, the Court has addressed a state's attempt to
27

28 ⁷ Hereafter, 18 U.S.C. section 1151 will be referred to simply as "section 1151."

1 impose sales tax on purchases made by Indians residing on another tribe's reservation. In *Washington v.*
2 *Confederated Tribes of the Colville Indian Reservation* (1980) 447 U.S. 134 ["Colville"], the Court
3 recognized that the state's ability to tax individuals or transactions on an Indian reservation depends
4 upon a balancing of interests:

5 The principle of tribal self-government, grounded in notions of inherent sovereignty and
6 in congressional policies, seeks an accommodation between the interests of the Tribes
7 and the Federal Government, on the one hand, and those of the State, on the other. . . .
8 While the Tribes do have an interest in raising revenues for essential governmental
9 programs, that interest is strongest when the revenues are derived from value generated
on the reservation by activities involving the Tribes and when the taxpayer is the
recipient of tribal services. The State also has a legitimate governmental interest in
raising revenues, and that interest is likewise strongest when the tax is directed at off-
reservation value and when the taxpayer is the recipient of state services.

10 (*Colville*, at pp. 156-157 [citations omitted].) Applying that balancing test, the Court held that
11 Washington could impose sales tax on purchases made by non-member Indians on the tribe's
12 reservation:

13 [T]he imposition of Washington's tax on these purchasers [does not] contravene the
14 principle of tribal self-government, for the simple reason that nonmembers are not
15 constituents of the governing Tribe. For most practical purposes those Indians stand on
16 the same footing as non-Indians resident on the reservation. There is no evidence that
nonmembers have a say in tribal affairs or significantly share in tribal disbursements. We
find, therefore, that the State's interest in taxing these purchasers outweighs any tribal
interest that may exist in preventing the State from imposing its taxes.

17 (*Id.*, at p. 161.) The Court also addressed the applicability of *McClanahan*, stating that it was clear after
18 *McClanahan* that sales tax could not be applied to reservation purchases by tribal members. The Court
19 then agreed with Washington's contention that the *McClanahan* exemption does not extend to
20 nonmembers of the governing tribe. (*Id.*, at p. 160.)

21 Prior to *Colville*, state courts in New Mexico, Montana, and Minnesota had all held that
22 *McClanahan*'s presumption against state taxation applied to the reservation-sourced income of Indians
23 who lived on another tribe's reservation. (*Fox v. Bureau of Revenue* (N.M. App. 1979) 87 N.M. 261;
24 *LaRoque v. State of Montana* (Mont. 1978) 178 Mont. 315; *Topash v. Commissioner of Revenue* (Minn.
25 1980) 291 N.W.2d 679.) However, none of those cases are still good law because each state revisited its
26 reasoning in light of *Colville*. In New Mexico, *Fox* was overruled by *New Mexico Taxation & Revenue*
27 *Dept. v. Greaves* (N.M. App. 1993) 116 N.M. 508. In Montana, *LaRoque* was superseded by
28 administrative regulation 42.15.121(1). In Minnesota, the reasoning in *Topash* was abrogated by

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 *Minnesota v. R.M.H.* (Minn. 2000) 617 N.W.2d 55.

2 Expressly applying *Colville* to a state income tax, the courts in Wisconsin and New
3 Mexico have now held that a state may tax the reservation-sourced income of an Indian who lived and
4 worked on another tribe's reservation. (*LaRock v. Wisconsin Dept. of Revenue* (2001) 241 Wis.2d 87;
5 *New Mexico Taxation & Revenue Dept. v. Greaves, supra.*) Similarly, the Oregon Tax Court held that
6 the state may tax income earned outside the state by an Indian who resided on another tribe's reservation
7 within the State of Oregon. (*Esquiro v. Dept. of Revenue* (1997) 14 O.T.R. 130, affd. 328 Or. 37.) The
8 Wisconsin Supreme Court's discussion of this point is illustrative:

9 Prior to *Colville*, several jurisdictions did hold that *McClanahan* exempted all American
10 Indians on any tribal lands from state taxation. . . . However, . . . New Mexico, Montana,
11 and Minnesota have all revisited this same issue in light of *Colville* and recognized the
12 distinction between a nonmember Indian on the lands of another tribe and tribal members
13 on their own lands. Moreover, Arizona applied *Colville* to find the same distinction
14 Indeed, the only jurisdictions that provide nonmember Indians on the lands of another
15 tribe with the same *McClanahan* tax-exempt status as tribal members on their own tribal
16 lands are those such as Oregon and Idaho, which have statutes granting an income tax
17 exemption for all American Indians on Indian lands within their borders, or North
18 Dakota, which has not confronted the issue since *Colville*. . . . Consequently, we do not
19 accept the argument that *Colville* is confined to the subject of state sales and use taxes;
20 instead, we regard it as a watershed case that further clarifies the general principles set
21 forth in *McClanahan*.

22 (*LaRock v. Wisconsin Dept. of Revenue, supra*, 241 Wis.2d at p. 100 [internal citations omitted].)

23 California's initial application of *Colville* was in the context of a criminal prosecution.
24 (*People v. McCovey* (1984) 36 Cal.3d 517.) In that case, two Indians were convicted of catching and
25 selling salmon on the Hoopa Valley Indian Reservation in violation of the Fish and Game Code. One of
26 the Indians was a member of the reservation's governing tribe and the other was not. The California
27 Supreme Court reversed the conviction of the Indian who was a member of the Hoopa Valley tribe
28 because the exercise of state jurisdiction was preempted by federal law. (*Id.*, at pp. 530-533.) However,
citing the above-quoted holding in *Colville*, the Court upheld the conviction of the Indian who was not a
member of the Hoopa Valley tribe. (*Id.*, at p. 536.)

The Ninth Circuit Court of Appeals has considered the implications of *Colville* in the
context of state sales tax. (*Barona Band of Mission Indians v. Yee* (9th Cir. 2009) 528 F.3d 1184.) In
that case, the Barona Band of Mission Indians marketed a sales tax exemption to non-Indians as part of a
business strategy during the expansion of their casino complex. The tribe entered into a lump-sup

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 contract with a non-Indian general contractor to construct the expansion. Under the terms of the prime
2 contract, the tribe purported to allow subcontractors to avoid sales tax by scheduling deliveries of
3 construction materials to occur on tribal lands. (*Id.* at p. 1187.) Applying the principles of *Colville*, the
4 court declined to extend the preemption doctrine to cloak the tribe’s business practice. The court
5 reasoned that the preemption balance shifted toward the state’s interests. The court explained that the
6 right of territorial autonomy is significantly compromised by the Tribe’s invitation to the non-Indian
7 subcontractor to theoretically consummate purchases on its tribal land for the sole purpose of receiving
8 preferential tax treatment. (*Id.* at 1191.) In *Barona*, the court ultimately found that, in the factual
9 context presented, the general state interests of raising revenue and consistent application of its tax laws
10 trump the weak interest of the Tribe and federal government. (*Id.* at p. 1193.)

11 In *McClanahan*, the Supreme Court found the tax preempted where the Indian’s income
12 was “derived wholly from reservation sources.” (*McClanahan, supra*, 411 U.S. at p. 165.) The Court
13 also described the Indian’s income as being “derived from within the Navajo Reservation” (*Id.*) and
14 “earned exclusively on the reservation.” (*Id.*, at p. 168.)

15 In *Oklahoma Tax Commission v. Sac & Fox Nation, supra*, the Court heard an argument
16 that the state should not tax “the income of people who earn their income within Sac and Fox territory
17 and of people who reside within the Tribe’s jurisdiction.” (508 U.S. at p. 120.) The Court held that the
18 *McClanahan* presumption against taxation extended to all “Indian country” and remanded the case for
19 further proceedings to determine whether the individuals lived in Indian country. (*Id.* at p. 128.)

20 In *Marboy v. Utah State Tax Commission* (Utah 1995) 904 P.2d 662 (“*Marboy*”), the
21 Utah Supreme Court discussed the state’s right to impose income tax on a married couple who were
22 Indians, who lived and worked on their own tribe’s reservation, and who were employed by entities
23 other than the tribe. The wife was an employee of the state government, while the husband was a local
24 County Commissioner (i.e., an elected official). After discussing numerous federal cases, including
25 *McClanahan* and *Colville*, the Utah Supreme Court concluded that Utah’s income tax was preempted
26 with regard to the wife, but not with regard to the husband. While the state’s interests in the wife’s
27 employment were no more than any private employer with an employee performing similar duties, the
28 state had a compelling interest in the husband’s employment as an elected official. The Court found that

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board’s decision or opinion.

1 distinction sufficient to support a state interest in taxing the husband's income, but not the wife's.
2 (*Marboy, supra*, 904 P.2d at pp. 669-670.)

3 Board Jurisdiction

4 Article III, section 3.5, subsections (a) and (b), of the California Constitution precludes
5 the Board from declaring a California statute unconstitutional unless an appellate court has made the
6 determination that the statute is unconstitutional. Subsection (c) of Article III, section 3.5 of the
7 California Constitution precludes the Board from refusing to enforce a California statute on the basis
8 that federal law or federal regulations prohibit the enforcement of the California statute, stating in
9 relevant part:

10 An administrative agency, including an administrative agency created by the Constitution
11 or an initiative statute, has no power . . . (c) To declare a statute unenforceable, or to
12 refuse to enforce a statute on the basis that federal law or federal regulations prohibit the
13 enforcement of such statute unless an appellate court has made a determination that the
14 enforcement of such statute is prohibited by federal law or federal regulations.

15 The Board also has a well-established policy of abstention from deciding constitutional
16 issues in appeals involving proposed assessments of additional tax. (*Appeal of Aimor Corp.*, 83-SBE-
17 221, Oct. 26, 1983.) This policy is based upon the absence of any specific statutory authority which
18 would allow the FTB to obtain judicial review of a decision in such cases and the Board's belief that
19 judicial review should be available for questions of constitutional importance. (*Appeals of Fred R.*
20 *Dauberger, et al.*, 82-SBE-082, March 31, 1982.) In the *Appeal of Aimor Corporation* (83-SBE-221),
21 decided on October 26, 1983, the Board stated:

22 This policy is based upon the absence of any specific statutory authority which would
23 allow the Franchise Tax Board to obtain judicial review of a decision in such cases and
24 upon our belief that judicial review should be available for questions of constitutional
25 importance. Since we cannot decide the remaining issues raised by appellant,
26 respondent's action in this matter must be sustained.

27 CONTENTIONS

28 Appellants' Contentions

Appellants contend that respondent is erroneously applying regulations based on cases
argued under principles of sovereignty. Appellants maintain that respondent should instead apply
principles of federal preemption especially for "California Indians."

Appellants also argue that California has a distinct legal history and experience with

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 Indian Tribes compared to other states. Appellants maintain that California has a history and practice of
2 treating the Indians of California as a group.

3 Appellants further argue that respondent's interpretation of Indian taxation exemption
4 criteria is inappropriate and reflects continued oppressive actions toward California's Indians.
5 Appellants explain that, due to the genocidal acts of 1850-1900, many Indians lost their homelands and
6 were forced into one of five reservations in California or indentured. Appellants maintain that some
7 Karuks were sent to the Hoopa Valley Reservation and that the Karuk Indians do not have reservations.
8 Therefore, appellants argue that it is impossible for many California Indians to comply with
9 respondent's requirements to be an Indian residing in the Indian country of your own tribe and receiving
10 income from that same tribe.

11 Appellants contend that respondent's definition of income from reservation sources is too
12 narrow. Citing *Bryan v. Itasca County* (1976) 426 U.S. 373 and *California v. Cabazon Band of Mission*
13 *Indians* (1987) 480 U.S. 202, appellants argue that, in the absence of express federal authorization, states
14 may not tax "on-reservation activities" of tribes or tribal members. Appellants argue that in
15 *McClanahan, supra*, the Supreme Court held that Arizona had no authority to tax the income of a
16 Navaho member who lived on the Navajo Reservation and derived his income from work he did on the
17 reservation. In addition, under *Marboyn, supra*, appellants argue that the court held Utah could not tax
18 the income of a state employee who worked for the Utah Department of Human Services as a therapist
19 for the San Juan Mental Health service, who was an enrolled member of that Navajo Nation who worked
20 and resided on the Navajo reservation. Appellants maintain these cases applied a wider definition of tax
21 exempt income that is consistent with "on-reservation activities." Appellants contend that exemption
22 from taxation should be granted where the individual is a member of a federally recognized tribe or on
23 the California Indian Roll, resides in California Indian country, and whose income is from activities
24 carried on from within the reservation rather than requiring the income be derived from reservation
25 sources of the tribe of which you are a member.

26 Appellants contend that, contrary to respondent's determination, appellant-wife is an
27 enrolled member of the Hoopa Valley Tribe. Appellants appear to argue that Laura Lee George
28 (appellant-wife) applied for and was granted membership in the Hoopa Valley Tribe. Appellants

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 explain that under *Short v. United States* (Ct. Cl. 1973) 486 F.2d 561, the Court of Claims established a
2 single reservation for the benefit of all Indians who were living within its boundaries. Appellants
3 maintain that P.L. 100-580 sets out the criteria for determining who is an Indian of the Hoopa Valley
4 and Yurok Reservations. Appellants argue that appellant-wife's membership in the Hoopa Valley Tribe
5 is evidenced by the fact that she is listed in the Federal Register on March 21, 1991. (See Appeal Letter,
6 exhibit D.) Appellants contend that Ms. George took the option to enroll in the Hoopa Valley Tribe and
7 was given membership by the Bureau of Indian Affairs. (Appeal Letter, exhibit E.)⁸

8 Appellants argue that their retirement income, which was received while residing on a
9 federal Indian reservation, is exempt from taxation. Appellants contend that R&TC section 17952.5 and
10 related federal laws prevent California from taxing pension income. Appellants, citing P.L. 83-280,
11 argue that the retirement income received comes from their "on-reservation activity" of retirement and
12 thus is exempt from taxation by California. Appellants argue that only the Hoopa Valley Tribe has the
13 authority to tax tribal residents on the Hoopa Valley Reservation, citing (*Bugenig v. Hoopa Valley Tribe*
14 (9th Cir. 2001) 266 F.3d 1201.) Appellants maintain that under P.L. 104-95, "no state may impose an
15 income tax on any retirement income of an individual who is not a resident or domiciliary of such state."
16 Appellants assert that as residents of the Hoopa Valley Reservation, they are not residents of California
17 and therefore, California may not tax their retirement income.

18 Respondent's Contentions

19 Respondent first contends that California residents are subject to tax on all income,
20 regardless of source and that the income at issue in this appeal is not reservation-source income.
21 Respondent asserts that there is an exemption from taxation for Indians who live on the reservation and
22 who derive income from reservation sources. Respondent argues, however, that the income must be
23 from "activities carried on within the boundaries of the reservation," citing *Mescalero Apache Tribe v.*
24 *Jones* (1973) 411 U.S. 145. Respondent asserts that appellants are receiving income from non-tribal
25 employers for services performed outside the reservation. Respondent contends that appellants admit to
26

27 ⁸ Appellants reference an appeal pending with respect to appellant-wife's enrollment in the Hoopa Valley Tribe. Appellants
28 should consider explaining at the oral hearing the status of appellant-wife's enrollment or membership in the Hoopa Valley
Tribe and how that affects appellant-wife's enrollment status in 2002 through 2005.

1 paying taxes (as they should have) on the wages as they received them.

2 Respondent contends that contrary to appellants' assertion, California is not prevented
3 from taxing pension income. Respondent argues that the services that gave rise to the pension income
4 occurred outside of Indian country. In addition, respondent argues that it is not prohibited from taxing
5 pension income because appellants now reside in a different state. Respondent maintains that although
6 appellants may be residents of the Hoopa Valley Tribe, they remain residents of California. Contrary to
7 appellants' contention, respondent asserts that the reservation is not deemed to be a state for purposes of
8 preventing double-taxation of pension income by two states.

9 With respect to appellant-wife's wages, respondent argues that it is not pre-empted from
10 collecting tax on wages earned from a non-Indian employer. Respondent argues that appellant-wife
11 worked for Klamath Trinity Unified, which is not an Indian Tribe or Indian employer and therefore
12 respondent may collect tax on her wages.

13 Although respondent agrees that California is prohibited, in some cases, from taxing the
14 reservation-source income of an Indian living on her own reservation, respondent contends this is not
15 applicable here because appellant-wife does not live on her own tribe's reservation. Asserting that the
16 prohibition is based in notions of tribal sovereignty, respondent argues that there is no interference with
17 tribal sovereignty when taxing the income of an Indian who does not live on her own tribe's reservation.
18 Citing *LaRock v. Wisconsin Dept. of Revenue, supra*, and *Colville, supra*, respondent argues that there
19 is a distinction between nonmember Indians living on another tribe's reservation and tribal members
20 living on their own reservation; a state may thus tax the income of a nonmember Indian living on tribal
21 lands. Thus, respondent contends that appellant-wife is no different from a non-Indian living on the
22 Hoopa Valley reservation and California may tax her income. Respondent contends it has applied
23 principles of tribal sovereignty in tandem with federal preemption because the cases consistently apply
24 both approaches. Further, respondent asserts that an analysis under federal preemption would yield the
25 same result.

26 Respondent also maintains that this appeal involves a question of federal preemption,
27 which is a constitutional issue. Respondent asks the Board to abstain from deciding the constitutional
28 issue and sustain its assessment. Appellants then can file a refund suit and seek a remedy in court.

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.

1 With respect to the post-amnesty penalty, respondent argues that the Board does not have
2 jurisdiction over a question relating solely to an un-paid post-amnesty penalty. Respondent contends
3 that once the penalty is paid, appellants may file a claim for refund on the limited grounds that the
4 amount of the penalty “was not properly computed by the Franchise Tax Board.”

5 STAFF COMMENTS

6 It appears to staff that appellants are primarily asserting that their income is exempt from
7 tax based on federal preemption arguments.⁹ The issue of whether a state statute is preempted by
8 federal law is a constitutional issue. (U.S. Const., art. VI, cl. 2.) The California Constitution prohibits
9 this Board from refusing to enforce a statute on the basis that it is preempted by federal law, unless an
10 appellate court has already made such a determination, and this Board has a long-established policy of
11 declining to consider such issues. (Cal. Const., art. III, § 3.5; *Appeal of Aimor Corporation, supra.*)

12 In light of the foregoing, it is the opinion of staff that, if the Board determines that
13 appellants have no viable arguments other than possible preemption arguments, it should sustain the
14 FTB’s action applying R&TC section 17041, which on its face imposes a tax on both the wage and
15 pension income at issue. Appellants could then pay the tax and file a refund suit so that the courts could
16 decide the issue.

17 With respect to the substance of appellants’ arguments, the parties should be prepared to
18 discuss whether federal preemption only applies if income is paid by a Tribe or whether it extends to all
19 income that is earned on the reservation. Although respondent contends that *McClanahan*, among other
20 authorities, contemplates federal preemption only where an Indian earns income from a tribal source, it
21 appears that those cases might be interpreted as requiring only that the income be earned within Indian
22 country, regardless of whether the tribe or some other entity is the employer. It appears to staff that
23 *Marboy* might support such an interpretation. However, we note that because *Marboy* was not issued by
24 a federal or California appellate court, and does not involve a California statute, it does not appear to
25 provide a basis for the Board to find that taxation of appellants’ income by California is preempted.

26
27
28 ⁹ We note that appellants also argue that R&TC section 17952.5, which addresses the taxation of certain types of retirement
income of nonresidents, prevents California from taxing their pension income. At the hearing, appellants should be prepared
to provide any cases or other authorities that support the assertion that R&TC section 17952.5 applies to Indians residing
within California on a reservation.

1 (See Cal. Code Regs., tit. 18, § 5412, subs. (b)(1) & (b)(2).)

2 If the Board reaches the substance of appellants' preemption arguments, but the Board
3 determines that the income at issue is not derived from reservation sources, it appears to staff that
4 respondent would be correct in taxing appellants' income. In this case, the Board would not need to
5 consider whether both appellants are a member of the governing tribe of the reservation on which they
6 reside.

7 If, however, the Board considers appellants' preemption arguments and determines that
8 either the retirement income or appellant-wife's Klamath Trinity Unified wages are reservation source
9 income, the Board should then determine whether each appellant is a member of the governing tribe
10 where they reside. It is undisputed that both appellants reside on the Hoopa Valley Reservation. It is
11 also undisputed that appellant-husband is an enrolled member of the Hoopa Valley Tribe. It is unclear,
12 however, whether appellant-wife is an enrolled member of the Karuk Tribe of California or a member of
13 the Hoopa Valley Tribe. Appellants state in their appeal letter that Ms. George is a member of the
14 Karuk Tribe of California, roll number 2140, but they later state that she "took the option to enroll in the
15 Hoopa Valley Tribe." At the hearing, appellants should be prepared to discuss appellant-wife's tribal
16 membership and whether such a determination is necessary to resolve this appeal.

17 The parties should be prepared to discuss the *McClanahan*, *Oklahoma Tax Commission*
18 and *Colville* cases and their application to the circumstances here. However, staff reiterates that where,
19 as appears to be the case here, there is no appellate decision declaring California's taxing statute
20 unenforceable, the California Constitution prohibits the Board from refusing to enforce the statute on the
21 basis of federal preemption or constitutional arguments. Accordingly, the parties should be prepared to
22 discuss whether any appellate court has made a determination that California may not tax the income of
23 an enrolled Indian under these circumstances.

24 Finally, it does not appear to staff that this Board has jurisdiction to review whether
25 respondent properly imposed the amnesty interest penalty because the penalty remains unpaid and
26 appellants have not filed a claim for refund disputing the correctness of the calculation of the penalty.
27 At the hearing, both parties should be prepared to discuss whether the Board has such jurisdiction.

28 ///

George_km

Appeal of Mervin L. George Sr. and Laura Lee George

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
review. It does not represent the Board's decision or opinion.