

KIRSCHLING v. UNITED STATES
1982 P-H 148,089

Editor's Summary

Key Topics

TAXES

- Gift

INDIANS

- Exemption from tax

Facts

The taxpayer, an Indian, received income from the sale of timber grown on reservation lands held in trust for her by the U.S. government under the General Allotment Act. Since, under this Act, the government was required to preserve the taxpayer's allotted interest in the land until it was distributed in fee simple to her, dispositions of this interest were tax-free while the trust relationship existed. Since the timber was part of her property interest, its sale was not taxable.

However, after receiving the sales proceeds, taxpayer gave a portion to a third party. The Government asserted that this transfer was subject to gift tax.

District Court

HELD: For the Government. The receipt of the sale proceeds constituted receipt of a fee simple interest in the timber. At that time, tax exemption under the Act lapsed. Therefore, taxpayer's subsequent transfer of proceeds to a third party was fully taxable as a gift.

Case Text

TANNER, District Judge: Findings Of Fact And Conclusion Of Law

Based on the pleadings submitted to date in the above captioned matter and having heard oral argument by counsel for both sides. This Court hereby denies Plaintiff's Motion for Summary Judgment and grants Defendant's Cross-motion for Partial Summary Judgment. In so doing, this Court makes the following Findings of Fact and Conclusions of Law:

Findings Of Fact

The Plaintiff, Helen Kirschling, was in 1976 an allottee of certain timber lands within the Quinault Indian Reservation in the State of Washington. Under the General Allotment Act of 1887 and Subsequent extension enactment's, the United States Government held these lands and the timber thereon in trust for the Plaintiff until such time as the land and timber would be turned over to her to own outright.

In 1976, the Plaintiff applied for and obtained five "Special Allotment Timber Cutting Permits." Under the terms of these permits, she was permitted to cut and remove a certain type and quantity of timber on her allotment land. She could perform the cutting herself or by contract she had to pay an administrative fee of five percent of the estimated stumpage value of the timber covered by the permit, which fee had to be paid to the Superintendent of the Western Washington Indian Agency, which agency is a governmental body coming under the Department of the Interior. Most sales of timber on allotment lands are negotiated through, and the proceeds are collected by the Bureau of Indian Affairs. However, where an allottee obtains a Special Allotment Timber Cutting Permit, the allottee may arrange his or her own sale and can have the proceeds paid directly to himself or sent to the Bureau of Indian Affairs.

In the present case Plaintiff arranged to have the timber sold to a third party who delivered to the Plaintiff, on September 2, 1976, a certified check for \$2,280,702 payable to the Bureau of Indian Affairs. She then called the Acting Superintendent of the Western Washington Agency to see whether she could deposit the check in her Individual Indian Money account (hereinafter IIM account). When he said there would be no problem, she deposited this check in her IIM account at the Bureau in Everett on September 3, 1976.

On October 1, 1976 she withdrew \$850,000 from her IIM account at the Bureau. She received two checks, drawn on the United States Treasury and payable to Plaintiff, in the amounts of \$750,000.00 and \$100,000.00 respectively, On October 4, 1976 she cashed the larger Treasury check at her bank in Tacoma and received six cashier's checks totaling \$750,000.00. Each of these checks was payable to a Mr. Duane Grandorff and was immediately delivered by Plaintiff to Mr. Grandorff. The disposition of the \$100,000 check is unknown and not important to this case.

Plaintiff concedes, for purposes of its Motion for Summary Judgment, that the transfer to Grandorff was a gift rather than consideration for property or services. The Defendant has never admitted this fact, but moves for partial summary judgment based on the factual assumption that the transfer was a gift.

Issues

1. Whether a gift of allotment property by an allottee to a non-Indian is subject to federal gift tax.
2. Whether a gift of cash owned outright by the donor at the time of the gift, but which can be traced to proceeds of harvesting timber on the donor's trust allotment, is subject to federal gift taxes.

Conclusions Of Law

A. Background of Taxation of Noncompetent Indian Allottees

Since there are evidently no reported cases dealing with the question of whether a noncompetent Indian allottee is subject to federal gift taxation on a gift arising from proceeds of allotted land, timber or other natural resources, it is necessary to examine the applicability of federal taxes, in general, to the receipt or transfer of such proceeds.

The leading case in the area is *Squire v. Capoeman*, 351 U.S. 1 [49 AFTR 178] (1956), which concerned income taxes on the receipt of proceeds from the sale of timber on trust allotments. There the Supreme Court made the following initial observation (p. 6):

We agree with the Government that Indians are citizens and that in ordinary affairs of life, not governed by treaties or remedial legislation, they are subject to the payment of income taxes as are other citizens. We also agree that, to be valid, exemptions to tax laws should be clearly expressed.

The cases following *Squire v. Capoeman* have consistently maintained that Indians are subject to income taxes unless specifically exempted by treaty or an act of Congress. See *Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973); *Fry v. United States*, 557 F.2d 646 [40 AFTR 2d 77-5288] (C.A. 9, 1977); *LaFontaine v. Commissioner*, 533 F.2d 382 [37 AFTR 2d 76-1162] (C.A. 8, 1976); *Commissioner v. Walker*, 326 F.2d 261 [13 AFTR 2d 433] (C.A. 9, 1964); *Jourdain v. Commissioner*, 71 T.C. 980 (1979); *Estate of Shelton v. Commissioner*, 68 T.C. 15 (1977). Although each of the above cases specifically dealt with the question of the applicability of the income tax to Indians, it logically follows that Indians are to be treated as ordinary citizens, subject to the payment of all taxes, unless specifically exempted. Accordingly, the Plaintiff is not exempt from the federal gift tax unless she can point to some treaty or Congressional enactment which specifically exempts her.

Like Plaintiff, the respondents in *Squire v. Capoeman* pointed to the commonly known General Allotment Act of 1887, c. 119, 24 Stat. 388, (25 U.S.C. ¶331 et seq.), as providing an exemption from payment of the taxes, there income taxes, at issue. By that Act, Congress outlined a plan for the eventual abolition of existing Indian reservations through the division of land among the tribes' members. The Act was intended to encourage Indians to give up their nomadic existence by offering to "any individual Indian who desires to do so . . . a fee simple title to a certain quantity of land, sufficient for him to make a living on as a farmer or grazer." (17 Cong. Rec., Part 1, p. 190). The Act directed that the reservation lands were to be divided with the Secretary of the Interior issuing to each Indian a patent declaring that his allotted property was held in trust for his sole use for a specific period of years.² At the expiration of that period, the land was then to be conveyed to the Indian "in fee, discharged of said trust and free of all charge or incumbrance whatsoever." Sec. 5, General Allotment Act (25 U.S.C. §348). Pursuant to Section 6 of the Act, upon the issuance of a patent in fee simple to the allottee, "thereafter all restrictions as to sale, incumbrance, or taxation of said land shall be removed..." Sec. 6, as amended by Act of May 8, 1906, c. 2348.34 Stat. 182 (25 U.S.C. §349).

In *Squire v. Capoeman*, the United States argued among other things that taxing the receipt of timber proceeds did not amount to a direct tax on the land and was therefore not a violation of the General Allotment Act. In holding for the taxpayer, the Supreme Court indicated that the severance and sale of the timber substantially reduced the value of the land, and that the imposition of any tax on the sale proceeds would violate the United States promise to eventually transfer the fee to the allottee "free of all charge or encumbrance whatsoever." 351 U.S., p. 3. The Supreme Court stated (pp. 9-10):

The purpose of the allotment system was to protect the Indians' interest and "to prepare the Indians to take their place as independent, qualified members of the modern body politic."... To this end, it is necessary to preserve the trust and income derived directly therefrom, but it is not necessary to exempt reinvestment income from tax burdens Once logged off, the land is of little value. The land no longer serves the purpose for which it was by treaty set aside to his ancestors, and for which it was allotted to him. It can no longer be adequate to his needs and serve the purpose of bringing him finally to a state of competency and independence, Unless the proceeds of the timber sale are preserved for respondent, he cannot go forward when declared competent with the necessary chance of economic survival in competition with others. [Citation and footnote omitted.]

Thus, by holding that the proceeds from the sale of timber from allotments were exempt from income taxes, the Supreme Court intended to conserve the value of the allottee's interest in the land itself. See *Mescalero Apache Tribe v. Jones*, supra, p. 156, fn. 12, where the Supreme Court reiterated the theory behind Squire--namely that without preservation of income derived directly from the land, the purpose of making the allotment would largely be frustrated.

B. Transfers to Persons for Whom the United States Will No Longer Hold the Property in Trust Should be Taxed.

The question of whether transfers which will remove the property from trust status should be exempted from gift and estate tax has been rarely, if ever, addressed squarely. It is true as Plaintiff notes in her reply brief that the three or four pertinent decisions involving the applicability of federal estate taxes have focused more on the status of the decedent Indian than that of the heir, devisee or legatee. But in almost all of the instances in which these courts mentioned the status of the property in the hands of the transferee, the allotment or trust status survived the transfer. Thus, in *Asenap v. United States*, 283 F.Supp. 566 [21 AFTR 2d 1609] (W.D. Okla. 1968), the court noted that all of the real properties in question continued to be held in trust for the benefit of the testamentary transferees. Supra at 568. In *Kirkwood v. Arenas*, 243 F.2d 863 (9th Cir. 1957), the court noted that (at p. 865): "The claimed inheritance tax was based upon the succession of [appellees] to the allotted lands." Finally, as defendant noted in its first brief, the court in *Nash v. Wiseman*, 227 F.Supp. 552 [13 AFTR 2d 1844] (W.D. Okla. 1963), specifically found that no patent in fee simple had been issued to the decedent's transferees on any of the property there transferred. Supra at 553.

Thus, it appears likely that none of the courts to date have been faced with a situation where the transfer in question terminated whatever allotment or trust relationship existed with respect to the property in question. In the present case, however, there can be simply no doubt that Grandorff, being a non-Indian, received a \$750,000.00 fund unrestricted by any allotment or trust relationship on the part of the United States.

As stated earlier, the underlying rationale for exempting the Indian from taxes on their allotted lands is that the United States is under an obligation, while the property is in trust, to hold it for the Indians until the day the property is turned over to one or more of them in fee, discharged of

said trust and free of all charge or encumbrance whatsoever." Sec. 5, General Allotment Act (25 U.S.C. §348). To the extent an inter vivos or testamentary transfer of the property has no effect on the existence of the trust relationship, the United States would have a continuing obligation to keep the property free from charge or encumbrance and the transfer would have to be exempted from Federal gift or estate taxes.³ But where, as in the present case, the property will no longer be subject to the trust relationship, the protection mandated by the General Allotment Act is inapplicable. As a result the exemption from taxation no longer governs.

Thus, the present transfer, to a person for whom the United States will not continue to hold the property in trust or allotment status, is not exempted from gift taxation. To the extent the transfer was a gift, it will necessarily be subject to the usual gift tax rules.

C. The Transfer Should be Taxed Since Plaintiff Had Received Fee Simple in \$850,000 of Her Allotment

The second reason for which the present transfer should be subject to the gift tax is that the \$750,000 fund Plaintiff transferred to Grandorff actually represented a \$750,000 portion of her allotment which she had converted into fee simple prior to the transfer.

To understand the parties' respective positions here, it is necessary to reemphasize that the exemption claimed by the Plaintiff in the present instance is not dependent upon the fact that the funds in question can be traced to a trust or restricted account held by the Bureau of Indian Affairs. The unimportance of a trust or restricted account status was clearly decided in *Oklahoma Tax Commission v. United States*, 319 U.S. 598 (1943).

Instead, Plaintiff is claiming an exemption based on the allotment status of certain real estate which the United States promised to return to her some day in fee simple. In *Squire v. Capoeman*, supra, the Supreme Court reasoned that since the timber on this reservation land was such a valuable part of the allotment property, the timber must be viewed as part of the fee simple which the United States had promised to return. Thus, imposition of an income tax on the act of converting the timber into proceeds would necessarily reduce the fee to be received by the Indian. Accordingly, it is no doubt true in the present case that Plaintiff has been able to rely upon *Squire*, supra, in order to avoid income tax on the substantial income she must have realized upon converting approximately two million dollars worth of her allotment into proceeds in the fall of 1976.

Obviously, when an Indian converts the timber into proceeds, he or she is likely sooner or later to end up with a fee simple in the proceeds. This fact merely reinforces the reasoning of *Squire*, supra. Moreover, where the Indian dies before receiving that fee simple, *Nash v. Wiseman*, supra and Revenue Ruling 69-164, 1969-1 C.B. 220, teach that the transfer of such proceeds will be exempt from estate taxation.

But in the present case the Plaintiff actually did receive the fee simple title to \$850,000 of her proceeds on October 1, 1976. Thus, on that date, Plaintiff had fully succeeded in converting an \$850,000 portion of her allotment into a cash fund of \$850,000 which she owned outright. At that

point, the United States had fulfilled its obligations to preserve, protect and ultimately return that portion of her allotment to her intact. The allotment and/or trust status had ceased as to such portion of her allotment. What she did with the property from that point on was her choice and her business. Without wishing to sound morose, if she had died that afternoon and the \$850,000 had been transferred by will or intestate laws, it would necessarily have been included in her taxable estate, just as the \$9,258.79 cash owned outright by the decedent in *Asenap v. United States*, supra, was conceded to be subject to Federal estate taxes.

Plaintiff did effect a transfer of \$750,000 of this \$850,000 total within a few days after October 1, 1976. If that transfer constituted a gift, it was a gift not protected by any exemption from the General Allotment Act. It was simply a taxable gift.

The Plaintiff has attempted to belittle the fact that she received the fee by arguing that she could not have effected a transfer of IIM funds directly to Grandorff. However, there are several factors which lessen the appeal of her alleged predicament. The first is that there is no evidence in the record proving that she could not have made a gift to Grandorff of part of her timber on the allotment. Second, she actually had control of the proceeds in question as soon as she had performed the terms of her contract with the third party who cut the timber. Thus, there was nothing in the Special Allotment Timber Cutting Permit requiring such third party to pay the proceeds to the Bureau. Perhaps she could have directed the third party to pay a portion of the proceeds directly to Grandorff.

What she evidently did was to ask the third party to write out a check payable to the Bureau, deposit it in her IIM account, draw out a check payable to herself roughly 30 days later, cash that check, buy six cashier's checks and deliver them to Grandorff. To the extent she could have structured the transaction in some way other than having \$750,000 pass through her hands, she cannot be heard to argue substance over form. See *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134,149, [33 AFTR 2d 74-1347] (1974) and the numerous cases cited therein.

However, even assuming there was no way for her to effect the transfer to Grandorff in any manner other than the one she chose, this would not entitle her to exemption for the transfer which she actually made. Just because a taxpayer is prevented from structuring a transaction in a way that will reduce or prevent taxation does not entitle him to effect the transaction another way and still claim the more advantageous tax consequences. Indeed, Plaintiff's situation is hardly unique in the tax law. Another prime example would be the situation which occurred when taxpayers in the community property states were permitted to split their incomes while those in common law property states could not, even though the latter taxpayers effected a legally equivalent result, i.e., the earner--spouse would assign half of his or her income to the other spouse. After this inequity had existed for many years, the problem was finally remedied with Congressional legislation in 1948. Perhaps legislation should be directed at the present problem as well. Until then, however, the law must be applied to the transfer actually made by Plaintiff, not some other transfer she may or may not have had the power to make.

Finally, we should be careful not to overemphasize the fact that Plaintiff received the fee simple in

\$750,000 of her allotment for only a short period of time. If she had changed her mind prior to delivery of the funds to Grandorff on October 4, 1976, there was nothing to stop her from disposing of the funds in any other way. Moreover, she could have held the funds a day, a week, a month, a year or perhaps longer before transferring part or all of them to Grandorff. Any attempt to fix some arbitrary rule for how long one must hold the fee before the period will be countenance for gift tax purposes is sure to end in frustration. The practical answer from an administrative standpoint is one which comports well with the theoretical answer compelled above: whenever the Indian's allotment property, or here a portion of it, has been converted into a fee simple outright, the income and transfer tax exemptions no longer apply. Any later gift of the property must be subject to the same gift tax rules which apply to all other citizens.

Conclusion

For the reasons stated above, this court hereby Denies the Plaintiff's Motion for Summary Judgment and Grants Partial Summary Judgment to the Defendant.

1 Such sales fall into the categories of "advertised" sales or "negotiated" sales.

2 Although initially established for a term of 25 years (Sec. 5 (25 U.S.C. §348)), the trust period here involved has regularly been extended by Executive Order. See also Sec. 2, Act of June 18, 1934, c. 576, 48 Stat: 984 (25 U.S.C. §462) which provides that "The existing periods of trust placed upon any Indian lands and any restriction on alienation thereof are hereby extended and continued until otherwise directed by Congress."

3 As well as from state estate, inheritance or gift taxes. See e.g., *West v. Oklahoma Tax Commission*, 334 U.S. 717, 272-28 (1948).