



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #683

### **Tribal Tax Refund and Sharing Agreements (DOR -- Tax Administration)**

[LFB 2009-11 Budget Summary: Page 560, #9]

### **Use Tax Credit for Purchases Made on Native American Lands (General Fund Taxes -- General Sales and Use Tax)**

[LFB 2009-11 Budget Summary: Page 283, #9]

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#### **CURRENT LAW**

Under current law, the Department of Revenue (DOR) is authorized to enter into agreements to refund, to the tribal council having jurisdiction, cigarette and tobacco products taxes collected on the reservation or trust land on which the sale is made, if certain conditions are met.

#### **GOVERNOR**

Authorize DOR to enter into agreements with federally recognized American Indian tribes or bands in this state to collect, remit, and provide refunds of the following state taxes for activities that occur on tribal lands or are undertaken by tribal members outside of tribal lands: (a) individual income taxes; (b) withholding taxes; (c) sales and use taxes; (d) motor vehicle fuel taxes; and (e) alcoholic beverage taxes.

#### **DISCUSSION POINTS**

1. American Indians and American Indian businesses are subject to the federal individual and corporate income taxes, except for income received directly from treaty or trust resources, such as fish, timber, and livestock. In general, American Indians who work or live

outside of tribal lands are liable for state income, sales, and other taxes, while American Indians who reside on and derive their income from federally recognized tribal lands or treaty resources are not subject to state income taxes

2. Under Wisconsin law, income earned by American Indians who live or work off their tribal reservation is subject to the state individual income tax. The income of non-Indians who work on tribal reservations is also taxable, under the state individual income tax. Income earned by American Indians who both live and work on their tribal reservation is exempt from the individual income tax.

3. Both American Indian and non-Indian employers are required to withhold Wisconsin individual income taxes from their employees' wages. Similar to income tax provisions, there is no withholding requirement for the wages of American Indians who live and work on their tribal reservations. Income taxes must be withheld from the wages of American Indians who either live or work off the reservation. Income tax must be withheld from the wages of non-Indians. American Indian gambling casinos are required to withhold income taxes from the winnings of American Indians who live and/or win off their tribal reservation, and the winnings of non-Indians. American Indian and non-Indian employers are generally required to withhold 6% from the gross contract fee of any non-resident entertainer who is paid in excess of \$3,200 for performance(s) in Wisconsin. An employer is not required to withhold on non-resident entertainers who furnish proof that they have filed a surety bond or cash deposit with DOR.

4. The income from the business activities of a tribe or American Indian corporation that is derived from such activities carried on only on the tribal reservation is exempt from the state corporate income and franchise tax. If a tribe or American Indian corporation's business activities are both on and off the reservation, the tribe or corporation is only taxed on the income derived from business transacted and property located off the reservation. However, a tribe or American Indian corporation is exempt from the state corporate income and franchise tax, if its activities off the tribe's reservation are limited to the solicitation of orders. A tribe or American Indian corporation whose shareholders, who control and operate the corporation, have sufficient business in Wisconsin to be considered doing business in the state, is subject to the state corporate income and franchise tax. A non-Indian corporation that owns property and/or conducts business on a reservation is generally subject to the state corporate income and franchise tax.

5. The state sales tax treatment of sales to American Indians and non-Indians depends upon the characteristics of the buyer. Whether the seller is an American Indian entity or non-Indian entity does not affect sales tax treatment. Sales made to an American Indian, Tribe, or American Indian business (corporation, partnership) on the buyer's tribal reservation are not subject to the state sales tax. Sales made to an American Indian, Tribe, or American Indian business that are off the purchaser's tribal reservation are subject to the state sales tax. Sales to non-Indians and non-Indian businesses are subject to the state sales tax both on and off tribal reservations.

Casino sales, rentals, or use of bingo cards and sales of bingo supplies to players who are American Indians and who live on the tribal reservation of the Tribe operating the casino or bingo

hall are not subject to the Wisconsin sales or use tax. Sales of meals, beverages, and lodging to American Indians who live on the tribal reservation of the Tribe that operates the casino are also not subject to the state sales tax. However, casino sales, rentals, or use of bingo cards to players who are non-Indian, American Indians who live off their tribal reservation, and American Indians who are members of a Tribe other than the Tribe that operates the casino are taxable. Similarly, sales of meals, beverages, and lodging to non-Indians, American Indians who live off of their tribal reservation, and American Indians who are not members of the tribe that operates the casino are taxable.

The sale of construction materials to an American Indian contractor are exempt from state sales taxation if: (a) delivery of the materials to the American Indian contractor occurs on that contractor's tribal reservation; and (b) the construction materials will be used on the American Indian contractor's tribal reservation. If the materials are later used off of the American Indian contractor's tribal reservation, the contractor would be subject to the state use tax. An American Indian contractor that takes delivery of construction material off its tribal reservation is subject to the state sales and use tax, unless federal preemption applies. The sale and delivery of construction material to a non-Indian contractor, on or off a tribal reservation, for use of on a construction project for the Tribe on the reservation, are subject to the state sales and use tax, unless federal preemption applies. Federal preemption applies if: (a) the construction activity is performed for the Tribe; (b) the construction occurs on the Tribal reservation; and (c) the construction project will benefit the Tribe (for example, schools, administration buildings, and casinos).

6. Under current law, wholesalers and retailers of motor vehicle fuel (gasoline and diesel fuel), alternate fuels, and general aviation fuel purchase the fuels from suppliers and wholesalers with state fuel taxes included in the purchase price. Wisconsin does not impose state fuel taxes on American Indians if the fuel is delivered to them on their tribal reservation, unless any portion of the fuel is purchased for resale to non-Indians. An American Indian that purchases fuel for resale to both American Indians and non-Indians must buy the fuel with Wisconsin fuel taxes included in the purchase price. If the reservation retailer makes a sale of fuel to a tribal member who resides on the reservation, the retailer should obtain a DOR exemption certificate from the buyer. The completed certificate must identify the purchaser as an American Indian and indicate that delivery of the fuel is taking place on the purchaser's reservation. The American Indian retailer then sells fuel to the American Indian purchaser at a sales price that excludes the state fuel tax. An American Indian retailer can only exempt fuel taxes on purchases made by tribal members who reside on the reservation. Other American Indian customers must pay state fuel taxes on their purchases. An American Indian retailer can file a claim for refund of the state fuel taxes originally paid to suppliers on nontaxable sales to American Indian customers. Fuel sales to American Indians who are not tribal members, or who do not reside on the reservation are not exempt. Non-Indians who purchase fuel that is delivered to them on a tribal reservation are subject to state fuel taxes

7. The state tax on cigarettes was converted from an occupational tax to an excise tax in 1983. This change allowed the state to impose the tax on sales of cigarettes made by Native Americans to non-Native Americans on reservations. Currently, the state has agreements with most Native American tribes through which Native American retailers purchase and sell only stamped

(taxed) cigarettes. The state then provides a refund to the tribes of 70% of the tax paid on sales to non-Native Americans, and 100% of the tax paid on sales to Native Americans (federal law prohibits states from imposing a cigarette tax on sales by Native Americans to Native Americans on reservations). The refund provision was enacted to encourage Native American retailers to sell only stamped cigarettes. Previously, unstamped cigarettes were sold on reservations, which raised concern regarding competition and the administration and collection of taxes for sales to non-Native Americans. The refund provision was enacted as part of the 1983-85 biennial budget (1983 Act 27).

8. The state tax on other tobacco products was converted from an occupational tax to an excise tax under 1999 Act 9 (the 1999-01 biennial budget act). Prior to Act 9, it was common for distributors to sell untaxed tobacco products to Native American retailers and to claim exemptions from the tax for such sales when filing tax returns with DOR. Act 9 specified that all tobacco products were subject to the tax unless specifically exempted, and imposed penalties on distributors who failed to collect and remit the appropriate tax. These changes meant that tribal retailers would no longer be able to purchase untaxed tobacco products. However, Act 9 authorized the Department to enter into agreements with the tribes to refund 100% of tobacco products taxes paid on sales to tribal members on reservations and 50% of such taxes paid on sales to non-tribal members. Although the refund rates for sales to non-tribal members differ, the provisions for tobacco products tax refunds are comparable to those for cigarette tax refunds to the tribes.

9. The occupational taxes on liquor, wine, and beer are paid to DOR by distilleries, wineries, and breweries and incorporated into the price of the product. American Indian and non-Indian retailers purchase liquor, beer, and wine from wholesalers with the tax already paid. When the products are resold to consumers, the occupational tax is passed on. American Indians who either live on or off the tribal reservation are not exempt from the taxes, whether the item is purchased on or off the reservation.

10. DOR indicates that the proposed authority to enter into tax sharing and refund agreements with state American Indian tribes would permit the Department to negotiate with the tribes to collect state taxes, such as income and sales taxes, owed by non-tribal members for transactions occurring on tribal lands. The agreements could be modeled after the current cigarette and tobacco product tax agreements, where DOR and the tribes share a percentage of total taxes collected. The agreements could be structured to improve compliance with specific tax laws, such as nonresident entertainer withholding for performers at tribal casinos, wage certification for delinquent taxes owed by tribal employees, and business tax registration of tribal business enterprises. According to DOR, compliance with certain tax administration provisions is uneven among the different tribes.

11. The budget bill's statutory provisions granting DOR authority to enter into agreements with American Indian tribes would require that all tax and financial information disclosed during negotiations, or exchanged pursuant to a final agreement, between DOR and a federally recognized American Indian tribe or band in this state be subject to state income and sales tax confidentiality provisions. The Department would be required to submit a copy of each agreement negotiated to the Joint Committee on Finance no later than 30 days after the agreement

was signed by the Department and the tribe or band. The fiscal effect of this provision would depend upon the terms of the agreements.

12. According to the National Conference of State Legislatures (NCSL), most states that have American Indian lands within their borders have reached some type of tax agreement with the tribes. The neighboring states of Michigan and Minnesota have tax sharing agreements with tribes.

*Michigan.* Michigan has individual tax sharing agreements with nine American Indian tribes. In general, the agreements cover the state sales and use tax, individual income tax, single business tax, motor fuel tax, and tobacco products tax. As an example, Michigan shares sales tax revenues collected inside tribal and trust lands with the Grand Traverse Band of Ottawa and Chippewa Indians as follows: (a) on the first \$5 million of annual gross receipts from non-tribal members, non-resident tribal members and all other taxable sales, two-thirds of the tax collected is paid to the tribe, and one-third is paid to the state; (b) on annual gross receipts from such sales in excess of \$5 million, half of the tax collected is paid to the Tribe, and half is paid to the state.

*Minnesota.* Minnesota has individual tax sharing agreements with 10 tribes. Generally, the agreements include sales and use taxes, cigarette and tobacco products taxes, liquor taxes, and motor fuel taxes. The agreement with the Fond du Lac Band of Lake Superior Chippewa provides that the band impose and collect the state sales tax on all transactions occurring on the reservation, and remit the taxes to the state. The state shares the collections with the tribe through two mechanisms. The state pays the tribe 50% of the sales and use tax base. The sales and use tax base is computed by: (a) adding the amount of sales and use tax collected from vendors on the reservation; (b) subtracting the per capita sales tax refund; and (c) adding the tribal use tax imposed on sales off the reservation to band members who live on or adjacent to the reservation. The use tax included in the sales tax base is \$136.60 per band member living on or adjacent to the reservation. The state also pays an annual per capita payment of \$45.50 for each band member who lives on or adjacent to the reservation. The payment is made quarterly, and is indexed.

13. According to a research study from the State-Tribal Relations Project published by the National Conference of State Legislatures (*States and Tribes: Building New Traditions, Piecing Together the State-Tribal Tax Puzzle*, Judy Zelio, NCSL, March 2005), depending on the type of arrangement, states and tribes can obtain the following benefits from cooperative tax arrangements: (a) predictable revenues for the state and tribes; (b) more equitable tax treatment of tribal and non-tribal businesses; (c) improved tax compliance from both non-Indian and American Indian transactions on tribal lands; (d) reduced state and tribal litigation costs; (e) new or expanded state and tribal programs or reduced state taxes funded by additional revenue generated by the agreements; and (f) more amicable relations among American Indian and non-Indian neighbors.

14. Under the tax sharing agreements the state would receive some revenues, such as sales taxes on non-Indians, that previously escaped taxation. A competitive advantage for American Indian businesses that are not imposing a tax would be reduced. The sharing agreements would reduce enforcement and compliance costs for both DOR and the Tribes.

15. The sharing agreements would recover less revenue for the state than would be the case with full compliance. In addition, the Department would continue to have administrative and compliance responsibilities for the taxes collected by the tribes. Depending on the type of sharing agreement that was negotiated, American Indian business could retain some competitive advantages.

16. The bill also includes a provision that would create a credit against the use tax equal to the amount subject to a tribal sales, use, or excise tax and paid to a federally recognized American Indian tribe or band in Wisconsin if the purchase, lease, or rental of taxable property or services occurred on tribal lands. Tribes have the right to impose sales, use, and excise taxes on purchases made on tribal lands but, to date, no Wisconsin tribes have done so. The intent of the proposed use tax credit is to allow the state to enter into revenue-sharing agreements with the tribes without resulting in double-taxation of state residents if the agreements include a tribal sales, use, or excise tax. The administration has requested two modifications to accomplish its intent: (a) only allow the credit as determined by an agreement between DOR and the tribal council; and (b) clarify that the credit would only apply if the tribal tax was imposed prior to imposition of the use tax.

## **ALTERNATIVES**

1. Adopt the Governor's recommendation with modifications to: (a) only allow the proposed use tax credit as determined by an agreement between DOR and the tribal council; and (b) clarify that the credit would only apply if the tribal tax was imposed prior to imposition of the use tax.

2. Delete the Governor's recommendation.

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