

Starting a Business on a Tribal Reservation

Periodically, the Tribe has been contacted by individuals interested in starting a business. The following is a general explanation of certain typical Federal and Louisiana tax issues relating to tribal members and other members of the community starting businesses that will operate wholly on the tribal reservation.

The information contained herein is a general explanation of certain principles of Federal and Louisiana tax law that apply to the type of transactions described in this article. You should not rely entirely on this information as support for any business plans that you have.

Should you desire advice concerning the application of these general principles to a particular set of facts, it is critical that you contact an attorney, tax advisor, accountant, or other qualified professional.

Frequently Asked Questions

- 1) What are the different types of business entity choices, and what are the advantages and disadvantages of each?

Corporation:

| <i>Advantages</i> | <i>Disadvantages</i> |
|---|---|
| Owners of the business enjoy complete personal liability protection for the debts of the business | Most costly to establish and operate from a compliance perspective |
| Entity choice that allows for the most capital to be raised | Corporation must pay taxes on its profits, and owners must pay taxes on the distributions of those profits, leading to double taxation |
| | Owners will not have the same exclusion for income earned on the reservation for the distribution of corporate profits as they would under a flow-through entity such as an LLC |

Limited Liability Company (LLC):

| | |
|--|---|
| Owners of the business enjoy complete limited liability for the business' debts | The compliance cost is greater than that of a sole proprietorship |
| The business profits and losses are passed out to the owners to report on their individual tax returns each year and are only taxed once, unlike a corporation | |
| The business profits and losses can be allocated to members in almost any fashion agreed to by the owners | |
| LLC's have become the preferred investment vehicle for entrepreneurs and investors who want to participate in the management of the entity's business and still limit their personal liability | |

Partnership:

| <i>Advantages</i> | <i>Disadvantages</i> |
|--|---|
| The same as LLC, except for liability protection | At least one partner has personal liability for the business' debts and liabilities |
| Offers advantages over an LLC in very limited scenarios and is less common than an LLC | |

S Corporation:

| <i>Advantages</i> | <i>Disadvantages</i> |
|--|--|
| Limited liability for business debts similar to that of a corporation | All items of income and distributions must be distributed pro-rata to ownership percentage |
| Business and profits of the business are taxed on the individuals tax return, similar to that of an LLC or partnership | Less flexibility in operations and more complex rules to stay in compliance with applicable tax laws |

Sole Proprietorship:

| <i>Advantages</i> | <i>Disadvantages</i> |
|---|--|
| There are little to no startup costs | There is no shield from personal liability for the business' debts and liabilities |
| Owners have complete authority over every step of the business | Relatively difficult to raise capital because investors want limited liability |
| Owners report the company's profits and losses on their individual tax return | |

Single Member Limited Liability Company (SMLLC):

| <i>Advantages</i> | <i>Disadvantages</i> |
|--|---|
| All the benefits of a limited liability company, including liability protection, but with only one owner/member | Costs slightly more than a sole proprietorship to start |
| There is no compliance costs for a separate tax return as the entity's profits and losses are reported on the individual's tax return like a sole proprietor | |

2) What is the difference between a state chartered entity and a tribal chartered entity?

A state chartered entity (corporation, LLC, etc.) is an entity that is established, operated, and organized under the laws and regulations of the State. Typically, a state chartered entity will be deemed to be doing business within the State and will be expected to pay taxes and file reports with the State. These generally include the filing of income tax returns, collection and remittance of sales tax, and registration with the Secretary of State to do business in the State.

A tribal chartered entity is an entity that is set up and governed by the laws of the Tribe. An entity set up under a tribal charter as a tribal corporation or tribal limited liability company (LLC) will be subject to any requirements of the Tribe, such as the filing of certain reports as required by the Tribe. There is no clear guidance on if a tribal chartered business wholly operating on the tribal reservation should register with the Secretary of State, file state income tax returns, or collect and remit state and local sales tax.

3) Are there any incentives or tax benefits available specifically for starting a business on a tribal reservation?

A federally recognized tribe is recognized as a sovereign entity for Federal purposes, but that special status generally does not apply to members of the tribe individually. For example, tribal members are subject to the same filing requirements as other individuals when it comes to federal individual income tax returns.

However, there are certain federal tax benefits available to businesses started and conducted wholly on federally recognized Indian reservations. First, depreciation for tax purposes has shorter lives and permits a faster depreciation deduction for qualified property placed in service on an Indian reservation. Reference IRS Publication 946 for up to date information regarding the depreciable lives of assets used in a business wholly on a tribal reservation.

Federal law also permits an Indian Employment Credit for wages paid to qualified employees. Generally, businesses eligible for this credit are those that hire American Indians who perform substantially all of their services for their employer on the reservation and live on or near the reservation. The federal credit amount in 2014 is equal to 20% of qualified wages and benefits paid to these qualified employees. Please reference IRS Form 8845 Instructions for up to date information regarding the qualifications and benefits of this income tax credit.

4) Are there any tax differences if the entity is owned by tribal members, non-tribal individuals, or a combination thereof?

For businesses wholly operated on the tribal reservation, there is no distinct difference in federal tax consequences for the individual owners, regardless of their tribal member status. The special status of the tribe as a sovereign nation generally does not apply to the individual tribe members.

However, there is a Louisiana state income tax advantage for tribe members who live on the reservation. Tribe members do not pay tax on their individual Louisiana income tax return on income derived on the tribal reservation if that member also lives on the reservation. Presumably, this tax exemption applies to income derived as an employee as well as from a pass-through entity such as an LLC. This exemption does not apply to corporate entities at the entity level.

5) Are there any tax differences if the entity is owned by persons who live on the reservation and persons who live outside the reservation?

Persons who live outside the reservation are generally considered to be residents of the State of Louisiana (or applicable state), regardless of their tribal member status. Income earned or passed through to a Louisiana resident is not eligible for the tax exemption described above in FAQ #4 which only applies to tribe members who both work and live on the reservation.

6) What are the tax implications if I own the business with my spouse, whether one or both of us is a member of the tribe?

See the answers to FAQ #4 and #5 above. There is no distinct difference in the taxation of a business when one or more owners are members of the tribe while one or more owners are not.

An LLC owned by a husband and wife is treated for tax purposes either as a sole proprietorship (single member LLC) or a partnership (non-single member LLC), depending in part on the state or jurisdiction where the LLC is located.

In certain instances, an LLC owned exclusively by a husband and wife can be treated as a single member LLC for income tax purposes and can avoid having to file a separate tax return in addition to their individual tax return. This is available if the business is wholly owned as community property under the laws of a state or possession of the United States, no other person can be considered an owner for federal tax purposes, and the business entity is not a corporation under applicable law. Louisiana is a community property state. The Chitimacha Tribe of Louisiana, as a sovereign nation, is not a community property jurisdiction.

7) Do I need to collect sales tax for sales made on the reservation?

Sales made on the reservation to tribe members are generally exempt from state and local sales taxes. However, there is a lack of clarity with regard to whether tribally chartered entities operating wholly on the reservation must collect state and local sales tax on sales made to non-tribal members. The State of Louisiana has not expressly required or exempted sales tax collection for sales made on the reservation to non-tribe members. However, in a 1980 court case the US Supreme Court upheld a state's right to collect sales tax on purchases by non-tribe members on the reservation.

For maximum protection, sellers should obtain Louisiana Form R-1046 (Sales Tax Exemption Certificate) from exempt purchasers to document the sales tax exemption claimed for the portion of their sales that qualify for this treatment.

8) Do I need to collect sales tax if I ship goods or provide services outside the reservation?

Note that a business located on the reservation that ships goods or provides services outside the reservation will not be regarded as a business "operated wholly on the tribal reservation," which is the scope provided for all other FAQ responses in this document.

In general, shipping goods to an off-reservation customer or providing services outside the tribal reservation will be a taxable event. Such sales may be taxed in multiple jurisdictions (e.g. the origin of the sale and/or the destination of the sale) depending on the sales tax laws in those jurisdictions.

The State of Louisiana sources sales to the destination in which goods are delivered or

services are provided. For example, if an on-reservation seller of tangible goods ships product(s) to a customer outside the reservation inside the State of Louisiana, the State of Louisiana has authority to collect sales tax and the seller is liable for collecting and remitting Louisiana state sales tax on that transaction.

Certain types of products and services are exempt from sales tax in Louisiana and other states. Your professional tax advisor can assist you in determining whether you must collect and remit sales tax for the specific products and services you sell in the jurisdictions where you do business.

9) What income tax returns do I need to file when I set up my business?

Corporations will be required to file federal Form 1120, US Corporation Income Tax Return. LLCs with more than one owner generally file Form 1065, US Return of Partnership Income for federal income tax purposes, and the owners of the LLC report their respective share of the LLC's activity on their personal income tax returns. Sole proprietors and single-member LLCs do not file an entity level tax return, but will include all their business profits and losses on Form 1040, Schedule C of their personal income tax return.

The requirement to file an income tax or franchise tax return with the State of Louisiana depends on the entity type and structure. State chartered corporations and non-single member LLCs can expect to file Louisiana income and/or franchise tax returns. Guidance for tribally chartered entities is unclear. The State of Louisiana has not expressly required or exempted tribally chartered businesses that operate exclusively on a tribal reservation from filing a state income or franchise tax return at the entity level.

However, as stated in FAQ #4 and #5, members of the tribe who are residents of the tribal reservation are exempt from Louisiana income tax income derived from sources on the tribal reservation. This includes income from a pass through entity (LLC – not single member) or income reported directly on an individual tax return (single member LLC or sole proprietorship).

10) Are there any additional considerations I will need to make when starting my business owned on the tribal reservation?

There are additional considerations that need to be taken into account depending on the entity structure, if you plan to have employees, or if you plan to operate in any capacity outside the tribal reservation. Items like income tax withholding, payroll tax returns, unemployment tax filings, state and local sales and use tax filings, and registering to do business in each state in which you are located are all things to take into consideration. This is not meant to be an exhaustive list, and these types of considerations should be made on a case by case basis. It is critical that you contact an attorney, tax advisor, accountant, or other qualified professional for further assistance.