

Tribal Taxation Initiative

Executive Summary

Actions today to defend and promote tribal sovereignty, nation-building and economic development are paramount in determining the role of tribes in the future. Under the Tribal Tax Initiative, national and regional tribal organizations have resolved to work together and with tribal leadership to achieve short-term strategic objectives that defend tribal sovereignty, strengthen nation-building and stimulate economic development. Through achievement of these short-term goals, the Initiative also seeks to lay a foundation for realizing a long-term vision of tribal self-determination and self-governance.

The issues for joint action in 2011-2012 emerged from the Native Nations Tribal Leaders Tax Summit held in April 2011 at Miccosukee. Four issues were prioritized for short-term impact from the many tax concerns facing tribes. Those issues were further advanced through discussion at the National Congress of American Indians (NCAI) mid-year conference. The four issues for Initiative joint action in 2011-2012 are as follows:

- 1) Ensure that tribal cultural and educational program benefits are exempt from taxation
- 2) Expand the availability of tribal tax-exempt bond financing
- 3) Prevent state taxation of improvements to tribal trust land
- 4) Respect tribal rights to regulate Indian commerce (PACT Act/Tobacco Compliance)

These four issues are *not* meant to be an all-inclusive list of taxation issues affecting tribes, but have been adopted to provide focus for immediate joint action in 2011-2012. The Initiative seeks to work in coordination to reinforce existing tribal efforts addressing these vital issues on a variety of levels:

- (1) Working with federal administrative agencies so they revise tax policies and programs to respect tribal sovereignty and promote tribal economic development ("Administrative");
- (2) Assisting tribal governments by sharing success stories, best practices and model tax code provisions to enhance revenue generation and strengthen tribal governance ("Governance and Capacity Building");
- (3) Promoting federal legislation consistent with tribal sovereignty and that fosters opportunity and sustained tribal economic development ("Legislative"); and
- (4) Monitoring court cases for potential threats and opportunities related to taxation, sovereignty and economic development matters ("Legal").

The Joint Action Plan that follows provides details of the Initiative's focus for 2011-2012. This Plan serves as a working document that will be further developed in consultation with partner organizations and modified as needed to address opportunities and challenges that may emerge.

Joint Action Plan

Tribes have long sought to stimulate reservation economies to usher in a new era of tribal self-determination. Expanding recent advances in achieving greater autonomy through economic development requires overcoming longstanding, persistent obstacles as well as impediments of more recent vintage. State governments, strapped for cash, have reached in to tribal economies for a share of tribal revenue through creative application of taxes and fees. The federal government has applied tax policy inconsistently and used field office audits to create unfavorable tax precedents as to what constitutes taxable income versus non-taxable tribal government services, as well as what constitutes essential versus commercial activity. In addition, the courts have rejected relief sought by tribes on state tax matters, thereby making economic growth more difficult by adding further uncertainty and risk. Scarce credit in the market and the nation's fragile economy pose additional challenges.

Removing barriers to tribal economic progress will require focused attention and action over a number of years. To provide this focus, national and regional tribal organizations have resolved to work with tribal leadership to strategically dismantle tax and finance barriers and navigate a path for success.

Conversations, roundtable discussions, meetings and calls over the past few years have propelled the creation of a multi-faceted tax policy initiative. The National Congress of American Indians (NCAI), the Native American Finance Officers Association (NAFOA), the United South and Eastern Tribes (USET) and the Affiliated Tribes of Northwest Indians (ATNI) have individually and collectively examined tax policy concerns with their leadership, membership base and expert practitioners to develop a joint action plan for policy changes in the short-term that would advance tribal self-governance. This joint action plan seeks to accomplish policy changes in 2011-2012 and to build momentum for longer-term governance and tax policy transformation.

The Native Nations Tribal Leaders Tax Summit held in April 2011 at Miccosukee identified four issues for short-term joint action that were further discussed and advanced in June 2011 at the NCAI mid-year conference. These four issues for strategic action in the short-term are as follows:

- 1) Ensure that tribal cultural and educational program benefits are exempt from taxation
- 2) Expand the availability of tribal tax-exempt bond financing
- 3) Prevent state taxation of improvements to tribal trust land
- 4) Respect tribal rights to regulate Indian commerce (PACT Act/Tobacco Compliance)

The four areas represent the key issues that present the best opportunities for short-term success and political traction. They are intended to provide a focus for joint action in the near-term. They are *not* meant to be an all-inclusive list of taxation issues affecting tribes.

The joint action plan is designed to work in coordination with and in support of existing tribal efforts addressing these vital issues. Although this plan does not set out a comprehensive list of strategic allies and partnerships, many of the actions identified below are designed to join with other initiatives to increase their impact for the best interests of Indian Country.

This joint tribal tax initiative orients action through four distinct, but interrelated forums:

- (1) federal administrative agencies ("Administrative");
- (2) tribal government ("Governance and Capacity Building");
- (3) federal legislation ("Legislative"); and
- (4) court cases ("Legal").

As set forth below, this joint action introduces each of the four issues and identifies strategic actions to be undertaken in each forum.

Issue 1: Exempt tribal government cultural and educational program benefits from federal taxation

Overview:

Under the IRS's General Welfare Doctrine, when tribal governments make payments to their members through social benefit programs for the promotion of general welfare, those payments are not taxable as part of the member's income. However, the IRS has taken the position that when tribal governments make payments (in cash or in kind) to tribal members made for reasons other than financial need, they do not fall under the general welfare doctrine. The IRS views tribal government benefits as being taxable to the member unless they meet one of the following three exceptions:

- they fall within a specific statutory exclusion in the Tax Code (e.g., IRC Sec. 117 excluding qualified scholarships); or
- they are provided to students and families based on financial need; or
- they are the type of benefits "routinely provided" by a state or local government, including public school systems

Among the tribal government program benefits the IRS has found to be subject to income tax withholding are (1) educational programs for elders (including cultural travel programs), (2) recreational and educational programs for youth that the IRS believes are different from those that local school districts or municipal recreation departments provide, (3) room and board, travel expenses and other assistance provided to college students who are not financially needy, (4) reimbursement of travel to meetings or events, such as meetings of national Indian organizations, powwows and other educational events that allow members to maintain their culture (including inter-tribal exchanges)

Strategic Actions:

Administrative: Inform and persuade IRS policy makers to adopt policy position that the General Welfare Doctrine must be applied in a flexible manner in the tribal context

- Call on Treasury and IRS to issue guidance that respects a tribal government's determination as to the cultural, education, health, housing and other programs that should be excluded from income under the General Welfare Doctrine
- Follow up with IRS/Treasury on consultation policy development, advisory committees and recommended revenue rulings

Tribal Governance and Capacity Building: Promote adoption of tribal code provisions establishing a Tribal Welfare Doctrine

- Distribute model General Welfare Doctrine code provisions and procedural guidance to tribes interested in establishing their own general welfare distribution mechanism under tribal law that are aligned with the IRS's General Welfare Doctrine but also allows discretion for each tribe to exercise its sovereignty
- Educate Tribal governments and finance officers about the utility of adopting "accountable plan" procedures for travel reimbursements and advances paid to tribal members selected to represent the Tribe at cultural events and meetings

Legislative: Work with Congress to enact federal legislation that exempts from federal income tax reporting cultural and educational program expenditures that are made by or through an Indian tribal government for the benefit of its members (including spouses and dependents)

- Continue efforts on the Elementary and Secondary Education Act Reauthorization to amend Section 117 to exclude tribal cultural and education program benefits and funding from tax and income tax reporting or withholding
- Maintain communications with the Senate Finance Committee to ensure that tax legislation supporting tribal interests in financing education and cultural preservation programs are included within any tax reform package

Expected Result (Impact):

- The number of IRS audit challenging the tax treatment of tribal government program benefits is diminished significantly or ceased altogether
- Tribal governments may design and enhance their educational and cultural programs for their members knowing that program impact will not be diminished by federal taxation of program benefits provided to members
- Tribal government investment of federal funding for their citizens' education is more cost-effective (no need to offset 10-28% for withholding federal taxes)

Issue 2: Expand Tribal Tax-Exempt Bond Financing

Overview: The Tax Code treats tax exempt bonds issued by Indian tribal governments differently than those issued by state and local governments. Unlike state and local governments, tribal governments may only issue tax-exempt bonds to finance projects that are deemed "essential governmental functions" of the tribe. The IRS has challenged tribal tax-exempt bond financing for the development of hotels, RV parks, water systems and other tribal projects to generate on-reservation revenues on the ground that those bonds serve a commercial, rather than governmental, function.

Tribes face other barriers to tax-exempt bond financing due to lack of access to the credit market and an insufficient tax base needed to secure such bonds. Meanwhile, state and local governments have property and other tax revenues available to serve as collateral for the bonds they issue. In addition, state and local governments may utilize federal guarantees in their issuance of housing bonds. Yet, provisions in the Indian Financing Act prohibit the use of federal guarantees as security for tribal tax-exempt bonds.

As a result of pressure from Tribes, Congress enacted a pilot tax-exempt Tribal Economic Development Bond (TEDB) program in the American Reinvestment and Recovery Act (ARRA) that eliminated the "essential governmental functions" and authorized tribes to use the bonds for any economic development project a state or local government could finance with tax-exempt bonds. The TEDB pilot program did not, however, contain provisions to address barriers related to credit access or security. In ARRA, Congress directed Treasury and IRS to determine whether permanent TEDB legislation is needed.

Strategic Actions:

Administrative: Press Treasury and IRS to adopt tax-exempt development bond program appropriate to the financing needs and sovereign status of Tribes

- Call on Treasury and IRS to complete the study of TEDBs mandated under ARRA, including its recommendation as to whether a permanent legislative fix is needed.
 - Call for Treasury/IRS to recommend tribal parity with states--at least with respect to tax-exempt financing for the development of infrastructure
 - Urge special consideration to include a more expansive realm of commercial developments within tax-exempt financed projects than local governments and states due to tribes' unique lack of a tax base
 - Highlight concerns regarding tribal access to credit markets and security
- Reach agreement with Treasury/IRS to implement administrative policy changes to the extent possible (in consultation with tribes) and to coordinate with tribes in promoting legislative changes

Legislative: Introduce legislation that removes barriers to tribal tax-exempt financing

- Work with Treasury and IRS to transform the TEDB study recommendations into permanent legislation
 - eliminate the "essential government function" test
 - authorize tribes to use federal guarantees for security and establish other means to improve credit access

Expected Result (Impact):

- Tax-exempt financing is utilized more frequently by tribes, providing lower interest rates and longer time horizons for reservation-based development projects.

Issue 3: Ensure tribal tax jurisdiction over activities occurring on leased rights-of-way and trust lands without interference by state and local government taxation.

Overview: Federal law prohibits the taxation of tribal- or Indian-owned lands held in trust or restricted status. State and local governments have increasingly sought to tax the economic activity taking place on tribal lands. Such taxation of activity on Indian lands diminishes the tribes' ability to raise revenue for their own needs and has hindered growth of tribal partnerships for economic development. Recent court cases have permitted state and local governmental taxation of on-reservation activities to the detriment of tribal taxation and business interests.

Strategic Actions:

Administrative: Establish provisions in the Department of Interior's new leasing regulations that preempt outside taxation of leases of tribal lands.

- Review Interior's proposed leasing regulations (Part 162) and submit comments addressing the relevant tax considerations

Tribal Governance and Capacity Building: Promote adoption of tribal tax code provisions for levying tribal taxes on economic activity taking place on Indian lands.

- Circulate model tax code provisions developed by tribes establishing tribal taxes on activities taking place on Indian lands
- Encourage tribes to be aware of the factors in the *Bracker* balancing test, as well as other federal preemption principles, when structuring business arrangements with outside parties on tribal land--e.g., the importance of maintaining tribal ownership and control, demonstrating that the economic activity is aimed at increasing Indian employment, and that the Tribe has added value to the product sold.

Legislative: Develop provisions exempting activities on trust land from outside taxation

- Support proposed energy legislation (such as S. 1684) that facilitates partnerships between Indian tribes and non-Indian energy development companies in a manner that does not cause a tax transfer to states. S. 1684 includes the concept of Tribal Energy Development Organizations (TEDOs).
- Draft proposed provisions to exempt activity on trust land from any outside taxation that can be included in national tax reform legislation and monitor opportunities to include such provisions in legislation advancing on Capitol Hill

Legal: Monitor cases and support efforts to present amicus briefs challenging outside taxation of activities on Indian lands

Expected Result (Impact):

- Development partnerships are made more viable and attractive to tribes and non-Indian businesses, improving prospects for economic development in Indian Country.
- Indian tribes retain more of the tax revenue from development projects.

Issue 4: Respect tribal rights to regulate commerce on Indian lands

Overview: In 2010 Congress enacted Prevent All Cigarette Trafficking Act (PACT Act) to restrict internet sales of untaxed cigarettes. Section 5 of PACT affirmed tribal sovereign immunity and limitations on state jurisdiction over on-reservation Indian commerce. Yet, many state governments have ignored the protections for Indian tribes in the PACT Act, and, with support from the federal Bureau of Alcohol, Tobacco, Firearms and Explosives (BATFE), have attempted to expand the reach of the PACT Act to require state licensing of tribal tobacco enterprises. A number of tribes have joined together as the Tribal Tobacco Compliance Network to demand respect of tribal rights to regulate commerce on their own reservations as mandated by federal law, which is reflected in Section 5 of the PACT Act. A legal challenge to other provisions of the PACT Act by a Seneca Nation Tobacco Retailer resulted in an injunction staying enforcement of many provisions of the PACT Act (*Red Earth, LLC v. United States*).

Administrative: Reverse federal agency positions supporting states' views on tobacco tax issues

- Continue to urge the Obama Administration to ensure that BATFE and the Department of Justice (DOJ) interpret the PACT Act to respect, and not interfere with, tribal rights to regulate commerce on their own reservations
- Develop position paper and actions to challenge efforts seeking to impose tobacco litigation Master Settlement Act (MSA) requirements upon Indian tribes

- Demand and participate in new consultation to discuss DOJ/BATFE positions that require retraction of these federal agencies' initial guidance

Tribal Governance and Capacity Building: Promote development of tribal tax and regulatory provisions governing on-reservation commerce

- Circulate model provisions developed by tribes to regulate their tribal economies

Legal: Monitor cases and support efforts to present amicus briefs affirming tribal rights to regulate on-reservation commerce without state interference

Expected Result (Impact):

- Tribal tobacco and other businesses are protected from outside licensing, regulatory and taxation bodies
- Protecting tribal businesses' ability to continue operations protects existing jobs, creates new jobs and, through tribal licensing, regulation and taxation, generates tribal revenue