

**Testimony of Christie J. Jacobs
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Before the Senate Committee on Indian Affairs

“New Tax Burdens on Tribal Self-Determination”

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Introduction

Good afternoon, Chairman Akaka, Vice Chairman Barrasso, and members of the Committee.

I appreciate the opportunity to be here this afternoon to discuss how the general welfare exclusion applies to tribal programs.

At the opening of my testimony, I want to acknowledge that the United States has a unique government-to-government relationship with Indian tribes as set forth in the Constitution of the United States, treaties, statutes, executive orders, and court decisions. The Office of Indian Tribal Governments within the Internal Revenue Service (IRS) was created in response to requests by tribal leaders. This office exists to facilitate the government-to-government relationship and to assist tribes in meeting their Federal tax obligations.

General Welfare Exclusion

The principle issue for discussion today is the general welfare exclusion. Tribes, like all governments, sponsor social welfare programs designed to support their members. Of principal relevance to the IRS is whether payments made through those social welfare programs are taxable. To be very clear, whether this exclusion is or is not applied does not limit what benefits or social programs tribes can provide to their members. The question is whether the provision of those benefits is excludable from gross income under the general welfare doctrine.

In order to provide context to this discussion I would like to briefly explain certain tax principles that apply to government social welfare programs, how the IRS has applied these principles in the past to tribal social welfare programs, and what the IRS is doing in order to address the concerns of the Indian tribal community on this topic.

Brief Explanation of Tax Principles

The two concepts relevant to this discussion are gross income and the IRS’s administrative general welfare exclusion from gross income.

Section 61 of the Internal Revenue Code (Code) provides that gross income includes all income, from whatever source derived, unless a specific exception in the Code applies. This provision establishes the general rule that income will be taxed unless it is expressly excluded from taxation.

The general welfare exclusion is, however, a non-Code exception. It is an administrative exclusion that has been developed in official IRS guidance and recognized by the courts and Congress over a fifty-five year period. See, e.g., Rev. Rul. 63-136, 1963-2 C.B. 19; *Graff v. Commissioner*, 673 F.2d 784 (5th Cir. 1982), *affg. per curiam* 74 T.C. 743 (1980); *Bailey v. Commissioner*, 88 T.C. 1293 (1987).

Some have expressed a concern that guidance on the general welfare exclusion lacks clarity because it is not found in the Code but in these other forms of administrative guidance and court decisions that stretch over five decades.

It is clear that the exclusion can apply to payments made by governmental units, tribal or non-tribal. Although Code section 61 defines broadly the items that are included in gross income, the IRS has consistently concluded that payments made to individuals by governmental units, under legislatively provided social benefit programs, for the promotion of the general welfare, are not includible in a recipient's gross income. See, e.g., Rev. Rul. 74-205, 1974-1 C.B. 20; Rev. Rul. 98-19, 1998-1 C.B. 840.

To qualify under the general welfare exclusion, payments must: (1) be made under a governmental program, (2) be for the promotion of general welfare (*i.e.*, be based generally on individual, family or other needs), and (3) not represent compensation for services.

I'd like to emphasize that the general welfare exclusion applies equally to general welfare program payments of all governments, tribal, federal, state, and local.

Past Application of the Exclusion to Tribal Programs

The IRS does not have and never has had a special program for examining tribal government social welfare programs. Historically, there were two primary ways that the IRS came to analyze tribal social welfare programs and whether payments made through these programs qualified for the general welfare exclusion.

One way that the IRS may come to examine a tribal program is for the tribe to seek a letter ruling from the IRS on the tax implications of a certain program. The IRS has historically provided all governments, tribal and non-tribal, with the opportunity to seek a letter ruling to determine if a certain program qualifies for the general welfare exclusion. Some tribes have availed themselves of this process. However, the expense, time needed, and the limited reliance provided by a letter ruling may have discouraged tribes from seeking letter rulings for their programs.

The second way tribal social programs may come under review is through an examination of a tribal government's tax reporting compliance. The Code requires all persons, including Indian tribal governments, to report certain payments of \$600 or more to the IRS. During an examination, a review of an Indian tribal government's books and records may show payments of \$600 or more to tribal members for social programs. These payments require further consideration, because payments to which the general welfare exclusion applies do not have to be reported.

The IRS always examines a program using the same three prong analysis of the general welfare exclusion. There has not been significant concern voiced to us regarding the first prong of this analysis: whether payments are being made from a government fund or not. The comments we have received on the application of the general welfare exclusion within the tribal context have been on the second and third prongs of the analysis: whether the payments are being disbursed based upon the needs of the recipient and whether the payments constitute compensation received for services.

For example, in one private letter ruling, a tribe provided certain educational assistance and benefit payments to its members who attended institutions of higher learning and vocational or occupational training. Most tribal members qualifying for assistance had an income below the national family median income level. In this instance, it was determined that the educational assistance payments were made to enhance educational opportunities for students from lower-income families and, therefore, were excluded from gross income because the payments were for the promotion of the general welfare.

In another ruling, it was determined that payments to participants in a tribal program designed to train unemployed and underemployed residents in construction skills were excluded from income under the general welfare exclusion because the primary purpose was training, which is based on the need for additional skills to prepare for the job market, and was not a payment for the compensation of services.

The difficulty in these examples and in applying the general welfare exclusion has been that each application is fact-specific and requires an independent analysis. The historical and cultural context within the tribal government context adds a layer of complexity to this analysis. Historically, tribes have expressed their concern to us that the IRS has not consistently applied the general welfare exclusion.

The IRS Response to Tribal Concerns

At various points, different tribes and tribal leaders have voiced concerns over the application of the exclusion provided under the general welfare doctrine. This issue came up through various levels of consultation and outreach with tribes and tribal leaders.

In November, 2011, in response to these consultation sessions, various meetings and general outreach with tribes and tribal leaders, and internal IRS and Treasury discussions, the IRS issued Notice 2011-94, which invited comments concerning the application of the general welfare exclusion to Indian tribal government programs. The purpose of the Notice was to begin a specific consultation process with tribes on how to find a solution that addressed their concerns and improved clarity and consistency of the tax law.

The IRS has received over 80 written comments from tribes and tribal leaders submitted in response to Notice 2011-94. We are still reviewing those comments as we consider the next step in this process. Additionally, the IRS and Treasury held a general welfare-specific consultation session in conjunction with the White House Tribal Nations Conference on November 30, 2011. It was attended by over one hundred tribal representatives. On March 8, 2012, Treasury and the IRS participated in a consultation session hosted by the National Congress of American Indians in conjunction with their annual conference and attended by approximately forty tribal representatives. On May 30, 2012, Treasury and IRS held a national phone forum that had over 150 participants. Recently, on June 6, 2012, the Advisory Committee on Tax Exempt and Government Entities, which is made up of representatives from the public including representatives of the tribal community, issued a report on the General Welfare Doctrine as Applied to Indian Tribal Governments and Their Members. We are currently reviewing the recommendations of the report and we expect to continue receiving comments as we move forward.

The IRS plans to publish written guidance that will address issues raised by tribes in their comments. Our intent is that this published guidance, along with improved internal coordination procedures, will provide increased clarity and consistency of the application of the general welfare doctrine. In the process of doing so, we will respond to many of the concerns which we have heard through the written and in-person consultation sessions. Our goal is to publish guidance as soon as possible. Tribal concerns are very important to us and we look forward to working with tribes on this item in the future.

This concludes my testimony and I would be happy to answer any questions you might have.