



NATIONAL CONGRESS OF AMERICAN INDIANS

July 12, 2013

Hon. Max Baucus
Chairman
Committee on Finance
United States Senate
219 Dirksen Office Building
Washington, DC 20510

Hon. Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Office Building
Washington, DC 20510

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Dear Senators Baucus and Hatch:

In response to your call to start with a "clean slate" approach to federal tax reform, NCAI is requesting that the Senate Finance Committee retain and improve key provisions treating Indian tribal governments in a manner consistent with their governmental status. In addition, in consideration of the Committee's goals (1) to help grow the economy, (2) to increase fairness and (3) to promote other important federal policies, we have proposed some additional changes to the existing Tax Code, which are briefly described below and addressed in more detail in an attachment to this letter. We wanted to share these recommendations with you as you continue your highly valued oversight of matters affecting tax reform in the U.S. Senate.

I. Economic Growth

In response to economic growth, tribes are continuously seeking new opportunities to attract businesses and jobs to reservation lands – where unemployment rates consistently rank among the highest in the Nation and the reality of little to no outside business investment is far too real. Incentives, such as the Indian Employment Tax Credit and Accelerated Depreciation for Business Property on an Indian Reservation, should be permanently extended and simplified in a manner that makes it easier for employers to utilize them. It has been difficult to attract long term investment in Indian country with tax incentives that are subject to uncertainty every year.

Further, finance tools that are meant to revitalize low-income communities, such as the New Markets Tax Credit, should be extended into Indian Country in a very real way. For example, while tribes are eligible to take advantage of NMTCs, during the last allocation by the U.S. Treasury, not one tribal project was allocated financing under the NMTC program: this happened despite the fact that several tribes submitted applications for NMTC financing. Tribes propose a permanent extension of the NMTC program with a tribal set aside provision to ensure that our communities are not left out in future rounds of allocations.

Finally, with regards to economic growth, tribes have repeatedly asked Congress to help them develop key energy resources on tribal lands. It is common knowledge that Indian Country is rich in natural resources, but relatively poor in resource development. When addressing tax reform, tribes ask that Congress seriously

consider permanently extending incentives such as the Production Tax Credit, and amending current law to allow tribes to utilize the credit even though they have no income tax liability to offset, such as by allowing tribes to monetize credits for qualifying projects on tribal lands. Also, Congress should explore extending the expired provisions for Clean Renewable Energy Bonds, with a tribal set-aside, or developing a similar grant program for energy development projects undertaken by Indian tribes or their wholly-owned enterprises

## **II. Government Fairness (and Economic Growth)**

Next, government fairness is a concern tribes have consistently raised since the commencement of tax reform discussions. Indian tribal governments have a unique status in our federal system under the U.S. Constitution and numerous federal laws, treaties and federal court decisions. Indian tribes have a governmental structure, and have the power and responsibility to enact civil and criminal laws regulating the conduct and affairs of their members and reservations. They operate and fund courts of law, police forces and fire departments. They provide a broad range of governmental services to their citizens, including education, transportation, public utilities, health, economic assistance, and domestic and social programs. Like states and local governments, tribes--as political bodies-- are not subject to income tax under the Code. However, unlike states and local governments, tribes are often left out of the Code entirely, or, when included in special governmental provisions – asked to meet additional thresholds or requirements which states and other local governments are not asked to meet, such as an "essential government function" test.

Naturally, tribes support the provisions in Section 7871 of the Code, 'Indian tribal governments treated as states for certain purposes,' because it acknowledges their status as governments and seeks to recognize their tax status as such. Unfortunately, Section 7871 contains several provisions that impose additional restrictions on tribes, and also fails to cover numerous Code provisions that provide special exemptions for state or local governments. While we believe that the tribes should be treated like states for all federal tax purposes, if Congress feels that it is necessary to specifically amend Section 7871 to provide parity, it should prioritize amendments to: (1) delete provisions from 7871 that impose special restrictions on tribal government debt, such as the essential governmental function test, (2) add provisions to Section 7871 to include tribal government plans in the definition of "governmental plans" for federal tax purposes, (3) conform excise tax exemptions available to tribal governments to those available to states, and (4) add provisions to Section 7871 to treat tribal government-controlled and tribally-funded charities as public charities, just like state government-controlled and funded charities are treated.

Specifically, in regards to government bond parity, Indian tribal governments feel the Committee's consideration of tribal tax-exempt financing in the context of tax reform is timely. There has been a need to change the tax law applicable to such bonds for years, but the current economic climate highlights in more detail the harsh realities of the financial market and the steep challenges faced by tribes in financing the many worthwhile projects in Indian Country. Now that the Treasury Department's study has acknowledged that current law is lacking in "tax parity, fairness, flexibility

and administrability,"<sup>1</sup> it is time for Congress to move forward and adopt new rules for tribal bonds, which: 1) eliminate the essential government function test; 2) avoid the imposition of unworkable restrictions (*e.g.*, territorial limitation on tribal bond financed facilities); and 3) repeal the prohibition on private activity bonds and instead institute a workable volume limitation procedure.

Further, tribes are not treated equally in critical areas that effectively limit their ability to provide basic services to their citizens, such as critical child welfare needs and much needed health services for tribal citizens. For example, under current law, Indian tribes are authorized to administer child support enforcement agencies, but these agencies are not afforded the same tools to encourage compliance with child support responsibilities on the reservation. Also, in regards to child welfare, tribal court determinations of 'special needs' are not given equal weight as state court determinations of the same. As a result, parents that adopt a 'special needs' child through state court are eligible to receive an increased adoption tax credit, whereas similarly situated parents that adopt through a tribal child welfare system are not eligible for the increased credit. These unfortunate inequities were almost certainly not intended by Congress and need to be remedied under any approach to comprehensive tax reform.

### ***III. Support for Important Federal Policies***

Finally, tribes lend unwavering support for inclusion of tax provisions which support important federal policies towards Indian tribes, such as protecting Indian tribes' right to self-govern, which includes the right to provide benefits and services to their tribal citizens based on community need, as well as the inherent right to practice cultural traditions. Such practices and ways of life have consistently been insulated from federal regulation (*See Santa Clara Pueblo v. Martinez*), and are protected through treaties and express federal laws such as the Indian Child Welfare Act, the American Indian Religious Freedom Act, the Indian Self-Determination and Education Assistance Act, *inter alia*.

However, recently, IRS field agents have become increasingly more active in Indian Country as evidenced by a recent report issued by the Treasury Inspector General for Tax Administration. The examinations by the IRS have overreached into tribal affairs to the point where Indian tribes are being asked, effectively, to alter traditional customs and practices in some instances. Tribes strongly urge Congress to pass legislation that excludes tribal government programs, services, and benefits authorized or administered by Indian tribes for tribal citizens, or others as determined by the Tribe, from inclusion in gross income under the General Welfare doctrine. Also, any legislation must further clarify that all honoraria, gifts, stipends or other income derived from the conduct and performance of traditional or ceremonial activities of Indian tribes are exempt from taxation. This provision appropriately acknowledges the community need addressed by individuals asked to perform these ceremonies and to lead these activities. A similar exemption from taxation has been codified in Section 7873 of the Code with respect to income derived from treaty-protected fishing rights.

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<sup>1</sup> See Department of Treasury, Report and Recommendations to Congress regarding Tribal Economic Development Bond Provision under Section 7871 of the Internal Revenue Code (December 19, 2011).

In conclusion, we appreciate your time and consideration of these important tax matters and hope to continue this dialogue with the Senate Committee on Finance, as well as the broader Congress when the time is appropriate. Again, we invite you to review our more detailed suggestions included in the attachment to this letter, and if you have any further questions or concerns on any of the items listed, please contact Derrick Beetso, NCAI Staff Attorney, at [dbeetso@ncai.org](mailto:dbeetso@ncai.org) or (202) 466-7767. Thanks again.

Sincerely,

A handwritten signature in cursive script that reads "Jefferson Keel". The signature is written in black ink and is positioned above the typed name and title.

Jefferson Keel  
NCAI, President

## Indian Tribal Government Submission on Tax Reform

### I. Introduction

In response to the call from Senators Baucus and Hatch to start with a "clean slate" approach to federal tax reform, the National Congress of American Indians (NCAI) requests that the Senate Finance Committee retain and improve key provisions treating Indian tribal governments in a manner consistent with their governmental status, as reflected under the U.S. Constitution and numerous federal laws, treaties and federal court decisions.

Tribal governments have the power and responsibility to enact civil and criminal laws regulating the conduct and affairs of their members and reservations. They operate and fund courts of law, police forces and fire departments. They provide a broad range of governmental services to their citizens, including education, transportation, public utilities, health, economic assistance, and domestic and social programs. Like states and local governments, tribes--as political bodies--are not subject to income tax under the Code. The non-taxable status of state, local and tribal governments should be maintained in any version of federal tax reform considered by this Congress.

#### A. SECTION 7871--TREATING TRIBES LIKE STATES

In 1982, Congress enacted a series of provisions aimed at treating Indian tribal governments like states for a variety of federal tax purposes, and these provisions were codified in Section 7871 (26 USC 7871). Unfortunately, Section 7871 contains several provisions that impose additional restrictions on tribes, and it also fails to cover numerous Code provisions that provide special exemptions for state or local governments. While we believe that the tribes should be treated like states for all federal tax purposes, if Congress feels that it is necessary to specifically amend Section 7871 to provide parity, it should prioritize amendments to: (1) delete provisions from 7871 that impose special restrictions on tribal government debt, such as the essential governmental function test, (2) add provisions to Section 7871 to include tribal government plans in the definition of "governmental plans" for federal tax purposes, (3) conform excise tax exemptions available to tribal governments to those available to states, and (4) add provisions to Section 7871 to treat tribal government-controlled and tribally-funded charities as public charities, just like state government-controlled and funded charities are treated.

Also, all previous efforts by Congress to acknowledge tribes' unique government character must be preserved, and in some instances improved upon [e.g., 7873—exempting income derived from the exercise of fishing rights; 139D—excluding qualifying health care benefits provided by Indian tribes from gross income; and 414(d)—which needs to be amended to omit the unworkable essential government function test used to classify employees under tribal government plans].

Further, the following are detailed suggestions for tax reform which are categorized according to the Committee's goals (1) to help grow the economy, (2) to increase fairness and (3) to promote other important federal policies.

## II. Key Provisions to Reform and Make Permanent

### A. HELP GROW THE ECONOMY

The following Tax Code modifications and extensions would help grow the economy.

#### 1. **Permanent Extension of Simplified Indian Employment Tax Credit.**

The Indian Employment Tax Credit (Section 45A) provides a 20 percent credit against income tax liability to employers for up to \$20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer for services performed by qualified employees. A "qualified employee" is an employee who is an enrolled member (or the spouse of an enrolled member) of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. The credit is due to expire for taxable years beginning after December 31, 2013.

**Proposal: Permanently extend the Indian employment credit and modify the base year from 1993 to the average of qualified wages and health insurance costs for the two tax years prior to the current year. This proposal is consistent with the legislative changes proposed in the Obama Administration's Fiscal Year 2014 budget. See *General Explanation of the Administration's Fiscal Year 2014 Revenue Proposals*, p. 14 (available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf>).**

**In addition, consider making the credit available to nonprofit and governmental employers by allowing the credit to offset employers' on-reservation payroll tax liabilities.**

#### 2. **New Markets Tax Credit--Permanent Extension with a Tribal Set Aside.**

The New Markets Tax Credit (NMTC) is a 39-percent credit for equity investments in a qualified community development entity (CDE) held for a period of seven years. A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on governing or advisory boards to the CDE; and (3) that is certified by the Treasury as being a qualified CDE. Treasury is authorized to designate targeted populations, including members of an Indian tribe, as low-income communities even if they do not meet the statistical tests that generally apply if they lack adequate access to loans or equity investments. The NMTC was extended by the American Taxpayer Relief Act of 2012 through 2013.

**Proposal: Permanently extend the NMTC, would increase the annual credit allocation amount to \$5 billion a year; in addition, provide that 3 percent or \$150 million of each year's allocation be set aside for Indian tribes, tribal entities and organizations established to primarily benefit Indian reservation communities.**

#### 3. **Energy Production Grants, plus Clean Renewable Energy Bonds.**

Current law provides production tax credits (PTCs) for renewable energy facilities constructed before the end of 2013. Section 45 of the IRC provides PTCs for wind, biomass, geothermal,

landfill gas, trash, qualified hydropower, and marine and hydrokinetic projects that generate electricity. Current law also provides an investment tax credit for energy property, which includes (1) property that is part of a facility that, but for the election to claim an investment tax credit, would qualify for a production tax credit; and (2) certain other listed property (including solar energy property). In addition, current law also provides grants for certain energy property on which construction began in 2009, 2010, or 2011.

**Proposal: Permanently extend the PTC for renewable energy property and make it refundable in a way that tribal governments can utilize the credit even though they have no income tax liability to offset. In addition, explore extending the expired provisions for Clean Renewable Energy Bonds, with a tribal government set-aside.**

#### **4. Indian Country Coal Production Tax Credit**

Under the 2005 Energy Policy Act, coal produced on land owned by an Indian tribe qualifies for a production tax credit equivalent to \$2 per ton through 2012. The American Taxpayer Relief Act extended the tax credit through 2013.

**Proposal: Extend the Tax Credit through 2020.**

#### **5. Empowerment Zones**

Currently, there are very few incentives in the U.S. Tax Code to effectively promote investment on Indian lands. Accelerated Depreciation and the Indian Employment Tax Credits have never been made permanent and they arguably provide very little in terms of new economic investment incentives on tribal lands. More must be provided within the U.S. Tax Code to support investment on Indian lands.

**Proposal: Congress should restore the treaty-recognized status of tribal lands as being immune from all federal and state taxation. To initiate this approach, Congress should establish a Tribal Empowerment Zone Demonstration Project including the following elements:**

- **50 Tribal Empowerment Zones established throughout Indian Country**
  - **25 of the most economically weak tribes**
  - **25 of the most economically entrepreneurial tribes**
- **No federal or state taxes of any kind within the zone**
- **Ten year demonstration project period**

### **B. FAIRNESS**

#### **1. Elimination of Special Restrictions on Tribal Government Debt**

Under current law, Indian tribal governments are generally permitted to issue tax-exempt bonds only to finance facilities that serve an "essential governmental function."<sup>1</sup> Such a requirement is not imposed on municipal debt. In addition, tribes (unlike states) are generally prohibited from issuing private activity bonds. Under these restrictive and discriminatory provisions, tribal

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<sup>1</sup> See, 25 U.S.C. 7871(c).

governments are limited to using tax-exempt financing only for certain government functions, such as roads, schools and sewage systems, while State and local government may use bonds to finance a much wider variety of government-sponsored job-creating projects (e.g., convention centers, tourist accommodations and public recreational facilities including golf courses, energy production and distribution facilities, parking structures and transportation projects). Both Congress and the Administration have recognized that current law is un-administrable and needs to be fixed.

**Proposal. Repeal the essential government function test and the general prohibition on tribal private activity bonds. With regard to the private activity bonds, develop a customized formula to determine the volume cap on private activity bonds issued by Indian tribal governments. A national tribal bond volume cap could be based on the greater of either: the minimum state volume cap, or the total population of all tribes. The national bond cap could then be allocated among all tribal issuers planning to issue private activity bonds in a given year under procedures developed and administered by Treasury.**

**Other than the special calculation of volume cap, private activity bonds issued by tribal governments would be subject to the same restrictions that apply to private activity bonds issued by other governments (e.g., the prohibition on using such bonds to finance skyboxes, airplanes, gambling facilities, health club facilities and liquor stores). Similarly, governmental bonds issued by tribes would be subject to the same restrictions and rules applicable to other governmental bonds.**

## **2. Tribal Government Pensions**

Under current law, tribal government plans are not treated the same as state and local pension plans. Tribal plans are not treated as "governmental plans" unless all of the employees in the plan are substantially engaged in "essential governmental" functions, and not commercial activities. Thus, current law contains the same un-administrable and unfair standard for tribal pension plans as it does for tribal bonds.

**Proposal: Equalize the treatment of tribal pension plans with that of state and local plans. Equal treatment could be achieved by amending the Internal Revenue Code in the following ways: (1) Delete the special tests applicable to tribal plans that are not imposed on state and local governmental plans (e.g., that all employees be engaged in "essential governmental functions"); (2) add the same distributions rights for tribal public safety employees that are available to state and local public safety employees; (3) confirm that pension plans may honor tribal court domestic relations orders that meet the same standards as state court orders; (4) grandfather tribal "457" plans that otherwise comply with the Code and were established before [2006], and (5) adopt the same employment tax rules for tribal deferred compensation plans that apply to state and local plans. The common theme of these Code amendments is to provide government fairness between Indian tribal plans and other government plans.**

## **3. Adoption Tax Credit**

Under current law, taxpayers that adopt children with special needs are eligible for an increased tax credit for qualified adoption expenses. However, if a tribal court -- instead of a state court -- makes the "special needs determination," the prospective adoptive parents cannot access the tax credit.



**Proposal: Place tribal court determinations as to the "special needs" of children on equal footing with similar determinations made in state court for purposes of the Code Section 23 adoption tax credit. This proposal is consistent with the legislative changes proposed in the Obama Administration's Fiscal Year 2014 budget. See *General Explanation of the Administration's Fiscal Year 2014 Revenue Proposals*, p. 214 (available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf>). Recognizing tribal court determinations also would align IRS tax policy with the policies codified in the Indian Child Welfare Act.**

#### **4. Child Support Enforcement**

The Social Security Act allows Indian tribal governments to establish Child Support Enforcement Agencies. Currently, there are more than 50 of these agencies throughout Indian Country. However, tribal Child Support Enforcement Agencies do not have all the powers of similar State-run organizations. These agencies do not have (1) access to parent locator databases, or (2) the authority under the Code to withhold past-due child support payments from the federal income tax returns of parents with past-due obligations. These two enforcement mechanisms are critical to improving the services provided by tribal child support enforcement agencies.

**Proposal: Amend the Social Security Act and the Internal Revenue Code to permit child support enforcement agencies to offset tax refunds for past-due payments and to access the same parent locator database available to State child support agencies.**

#### **5. IHS Loan Repayment Exclusion**

Under current law, loan amounts forgiven or repaid on an individual's behalf generally are considered taxable income. However, certain forgiven or cancelled student loan debt is excluded from income, including debt repaid under the National Health Service Corp ("NHSC") Loan Repayment Program. The Indian Health Service ("IHS") Health Professions Loan Forgiveness Program is very similar to the NHSC Loan Repayment Program. Under both programs, dentists, physicians, and nurses provide health care services to underserved populations in exchange for loan repayment assistance. However, the IHS Health Professions Loan Forgiveness Program does not enjoy the same preferential tax treatment as the NHSC program.

**Proposal: Amend the Internal Revenue Code to provide health care professionals who receive student loan repayments from IHS the same tax-free status enjoyed by those who receive NHSC loan repayments. This proposal is consistent with the legislative changes proposed in the Obama Administration's Fiscal Year 2014 budget. See *General Explanation of the Administration's Fiscal Year 2014 Revenue Proposals*, p. 132 (available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf>).**

### **C. PROMOTE IMPORTANT FEDERAL POLICY**

#### **1. General Welfare Exclusion for Cultural Activities**

Under current law, the general welfare doctrine applies to exclude income from governmental programs that are based on individual or family need, and not compensation for services. However, the IRS has recently broadened the doctrine to apply to certain tribal governmental

programs, including certain stipends and honoraria associated with Indian cultural activities. See <http://www.irs.gov/pub/irs-drop/n-12-75.pdf>.

**Proposal: Amend the Internal Revenue Code to clarify that all honoraria, gifts, stipends or other income derived from the conduct and performance of traditional or ceremonial activities of Indian tribes are exempt from taxation. This provision acknowledges the community need addressed by individuals asked to perform these ceremonies and to lead these activities. A similar exemption from taxation has been codified in Section 7873 of the Code with respect to income derived from treaty-protected fishing rights. Also, tribes strongly urge Congress to pass legislation that excludes tribal government programs, services, and benefits authorized or administered by Indian tribes for tribal citizens, or others as determined by the Tribe, from inclusion in gross income under the General Welfare doctrine.**

## **2. Exempt Tribal Government Distributions from the Kiddie Tax**

Under current law, unearned income in excess of \$1,900 of children under age 19, or of young adults age 19-24 who are full-time students, is taxed at the parent's marginal rate, if that rate is higher than what the child would otherwise pay. The purpose of this "kiddie tax" is to address instances of intergenerational income shifting, where a family would historically save large amounts of money by transferring highly appreciated investments to their children who enjoy a lower tax bracket. Unfortunately, however, the kiddie tax, as codified in Code Section 1(g), burdens many tribal minors and young adults with a higher tax rate on tribal distributions, including minors' trust distributions. The kiddie tax also may create a disincentive for some young tribal members with respect to pursuit of higher education.

**Proposal: Amend Code Section 1(g) to exempt tribal government distributions (whether derived from gaming or other tribal revenue sources) from the kiddie tax.**

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