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United States Senate

COMMITTEE ON INDIAN AFFAIRS

WASHINGTON, DC 20510-6450

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July 24, 2012

The Honorable Max Baucus
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Baucus:

I would like to thank you for holding a hearing on May 15, 2012 to address tax reform and how it affects Indian tribes. As you so aptly stated, the 15,000 changes made to the tax code since 1986 have created too much complexity and unfairness. Tax reform needs to simplify the tax code in a way that encourages economic growth in Indian Country and I commend the work you and your staff have done on this very important issue.

Over the last year, the Committee on Indian Affairs has held two oversight hearings and one roundtable dedicated to the topic of tribal tax reform. In every event, tribal witnesses have testified about the importance of tax-exempt bonds and how the current tax provisions need to be improved to spur economic development and job creation in tribal communities. Tribal leaders expressed serious concerns over changing Internal Revenue Service (IRS) policies that have allowed the government to tax tribal trust and the agency's inconsistent application of the general welfare doctrine to governmental benefits provided by tribes for their members.

Tribes have urged Congress to address IRS tax policy discrepancies by first leveling the playing field for tax-exempt bonds. Currently, tribal governments can only issue bonds for government buildings. In order to use the bonds, tribe must first pass an "essential government test." In contrast, States are currently allowed to issue tax-exempt bonds for *any* public purpose. States can use bonds to finance tourism and economic development projects like municipal golf courses, convention centers, and hotels.

To address this inequity, Congress authorized two billion dollars of tribal economic development bonds for any purpose other than gambling facilities in 2009. The Treasury Department studied the bond program and recommended that Congress repeal the essential government test. As part of tax reform, this test should be repealed now. The elimination of the limitation on tax-exempt bonds would free tribes to raise capital otherwise unavailable to them and make it possible for them to create their own solutions in today's difficult economic times.

Another area of concern for tribal governments is the taxation of tribal trust and settlements. Federal or tribal government payments to tribal members based upon treaty, statutory or judicial mandates or derived from Indian trust resources are not subject to Federal taxation. Per capita payments from tribal trust funds are specifically excluded from both federal and state taxes under the Per Capita Act of 1983. Long before 1983, this tax exclusion existed in federal law because it is derived from Indian treaties and the federal trust responsibility. Nevertheless, the IRS has embarked on an effort to tax per capita payments made to tribal members from trust funds.

The IRS is pursuing a significant change in federal policy regarding the status of tribal trust funds, both in their tax exempt status and in their exclusion from income for purposes of eligibility for federal programs. Tribes believe that the new IRS interpretation of the Per Capita Act of 1983, 25 U.S.C. § 117b, is in direct conflict with current regulations and policy at the Departments of Interior, HHS, Agriculture, HUD, Education, and the Social Security Administration.

Tribes are also concerned by the inconsistent application of the general welfare doctrine. Tribes, like all governments, provide many benefits to support their members including educational assistance and cultural awareness, along with housing and meals. The general welfare doctrine allows governments to provide benefits to citizens without those benefits counting as taxable income under section 61 of the Internal Revenue Code (Code). 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. Because the general welfare exclusion is not found in the Code, it is often unclear which benefits are eligible for the exemption. This uncertainty is tough on tribal governments and their members and it needs to be fixed.

One out of every four Native people in the U.S. lives in poverty. Tribal governments use a variety of programs to help provide for the general welfare of their people, especially because they are underserved across the board in education, infrastructure and social spending. Recent efforts by the IRS to audit important areas of tribal government support such as funeral benefits, education, and trust assets raise serious concerns about the federal trust relationship and the ability of tribal governments to sustain and support their members.

Eliminating the essential government function test on tribal-exempt bonds, keeping Federal or tribal government payments to tribal members based upon treaty, statutory or judicial mandates or derived from Indian trust resources free from Federal taxation, and reducing the uncertainty surrounding what tribal benefits are considered taxable income under the tax code would simplify the existing tax code provisions and ease the tax burden for tribal governments. Such tax reform would create certainty and stimulate economic growth in Indian Country at a time when such reform could really make a difference.

As you know, 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. Indian governments are in some ways similar to state governments; each provides hospitals, public schools and law enforcement. However, U.S. policies do not recognize tribal governments as fully-sovereign nations and, as tribes have expressed to both of our committees, IRS tax policies have been inconsistently applied for tribal governments.

I greatly appreciate your leadership and look forward to the collaboration between the Committee on Indian Affairs and the Finance Committee to better address these tax issues that are of greatest concern to tribes.

Aloha pumehana,

A handwritten signature in blue ink that reads "Daniel K. Akaka". The signature is written in a cursive, flowing style.

DANIEL K. AKAKA
Chairman