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**Before the**

**Subcommittee on Long-Term Growth and Debt Reduction**

**Of the Senate Committee on Finance**

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Thank you for the invitation to appear before the Subcommittee to address "Encouraging Economic Self-Determination in Indian Country" and, specifically, to discuss Tribal tax-exempt bond issues.

IRS ACT June 8, 2005 Report

For the past two years, I have served as a member of the IRS Act Advisory Committee on Tax-Exempt and Government Entities (the "ACT"). Attached is ACT's June 8, 2005 Report<sup>1</sup> (the "ACT 2005 Report") entitled "Survey and Review of Existing Information and Guidance for Indian Tribal Governments." This document was completed in 2005 after extensive consultation with Tribal Government officials; Tribal Government staff, including financial officers, internal and external accountants, and internal and external lawyers; and with Tribal members.

The ACT 2005 Report covers areas that are important to the economic development of Tribes in the United States. Its recommendations cover a number of significant topics; many recommendations include requests for guidance regarding topics such as the federal tax treatment of different legal structures used for Tribal businesses and Tribal economic development entities; tax treatment of Tribal trusts; and a definition of what constitutes "an essential governmental function" for purposes of Tribal tax-exempt financing.

In my testimony and written remarks, I would like to describe the economic dilemma that faces Tribes, outline some of the past and present efforts to address these financial challenges, and suggest some actions that would be useful in making significant progress towards the economic viability of Tribes.

Unique Status of Tribes

At the onset, I would like to emphasize that Indian Tribes are unique. We are not simply a racial group. We are not a state or local government. We are sovereign governments numbering over 560 federally recognized Tribes (the "Tribes"). Tribes maintain a government-to-government relationship with the United States Government. For additional information on this unique status, see page six of the ACT 2005 Report for an overview of the federal statutes

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<sup>1</sup> IRS Publication 4344 (Rev. 6-2005)

that reflect Congress' policy of encouraging economic development in Indian country. These statutes support self-government, self-determination, and self-sufficient Tribes.

#### Economic Status of Tribes

Historically, Tribes and Tribal members have been impoverished. Little or no economic activity has occurred on our Tribal lands, and we continue to be challenged by these circumstances today. Of the over 560 Tribes in the United States, only a few hundred are considered economically viable. Contrary to popular belief, not all Indians have become wealthy from Indian gaming. Most of our Indian brothers and sisters live on reservations that continue to be isolated and have high rates of unemployment, poverty and violence.

I am proud to say that throughout Indian country—even in the most remote reservations—strides have been made to change the circumstances of the People. Tribes have developed business initiatives and other programs for economic development; several excellent examples have been identified in recent testimony before the Senate Select Committee on Indian Affairs.

#### Revenue Generation Issues for Tribes

The ACT 2005 Report and recent testimony on economic development to the Senate Select Committee on Indian Affairs have highlighted the economic condition of Tribal members and the resulting implications for maintaining a viable tax base. State, local, and federal governments have a tax base that is sufficient to support government operations and the general welfare programs for their citizens.

Tribes have the authority to tax just like any other sovereign nation. Some Tribes are economically viable and do collect sufficient taxes to support Tribal programs; however, they remain the exception. Most Tribes are still fighting poverty, and thus cannot generate taxes sufficient revenue to provide for governmental services. In addition, Tribes face challenges from other taxing authorities, e.g., state and local governments that want "their share" or complain about unfair tax advantages that Tribes may have. The common areas of contention are cigarette and motor fuel taxes. These tax issues are often the subject of litigation or tax agreements.

In summary, Federal, state, or local governments can generate revenues to support their government operations and programs for their citizens by imposing taxes. However, given the economic conditions of its citizens, Tribes cannot depend on taxes and must look to other sources of revenue to support their government operations and programs for their citizens. This is an important point that cannot be emphasized enough or repeated enough.

#### Revenue Generation from Tribal Businesses

Because revenue is not available via taxation, Tribes have increasingly funded government operations and general welfare programs through Tribal-owned businesses. Tribes operate a variety of successful businesses around the country, thereby providing revenue to fund Tribal Government operations and programs.

The most well-known business endeavors are the Tribal casinos. In one example, a Tribal business entity operates a casino, it remits net gaming revenues after expenses to that Tribe's Government just like a corporation is required to pay taxes. The Tribe then uses the net gaming revenue for tribal government operations and programs to promote economic development, to donate to charitable organizations or to help fund operations of local government agencies. These priorities are set forth in the Indian Gaming Regulatory Act of 1988<sup>2</sup>.

### The Indian Reorganization Act and Tribal Economic Development

The earliest legislative support for Tribal economic development began more than 70 years ago. The Indian Reorganization Act of 1934 (the "IRA")<sup>3</sup> was designed to reduce the loss of Tribal lands, to provide economic development to Tribes, to encourage and provide for self-determination of Tribes, to recognize cultural plurality, and to revive Tribalism. The framers of the IRA thought that by granting Tribes a form of government and the power to enter into business, Tribes would then be equipped to participate in the mainstream economy.

Under the IRA, Tribal corporations were chartered by the Secretary of Interior. These so called "§17 Charters" from the Secretary of Interior allowed some Tribes to create business entities that pursued commercial endeavors. Although the IRA's early efforts were not ideal, they provided an early framework for Tribes to pursue economic development.

### Tribal Tax Exempt Bonds

The next significant federal initiative in support of Tribal economic development was the Indian Tribal Governmental Tax Status Act of 1982 (the "1982 Act")<sup>4</sup> and the regulations by the Treasury Department and the IRS to implement it.

As described on page eight of the ACT 2004 Report<sup>5</sup>, the 1982 Act permitted Tribal Governments to be treated as State governments for various tax purposes. Tribes could issue tax-exempt bonds for essential government functions within the following definition:

For purposes of this section, the term "essential governmental function" shall not include any function which is not customarily performed by State and local governments with general taxing powers.<sup>6</sup>

This definition has not provided helpful guidance. Tax-exempt bond financing is an economic development tool that state and local governments have used for decades. For example, state and local governments can use tax exempt financing to finance convention centers, airports, golf courses, and sports facilities and to entice for profit businesses to their communities.

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<sup>2</sup> 25 U.S.C. Section 2701(b)(3) and (d)(1)(A) (1988)

<sup>3</sup> 25 U.S.C. § 461 et seq.

<sup>4</sup> Pub. L. No. 100-203, ch.80, 96 Stat. 2607 (1982) (codified at I.R.C. Section 7871 (1993))

<sup>5</sup> IRS Publication 4344 (5-2004)

<sup>6</sup> 26 U.S.C.A. Section 7871(e)

Tribes need to be able to use tax-exempt bond financing in the same manner. However, when Tribes engaged in economic development activities typically performed by state and local governments, both Congress and the IRS Compliance Auditors have stated that such activities are not within the statutory definition and that Congress never meant for Tribes to engage in those activities. For example, state and local governments commonly fund golf courses with tax exempt financing. However, when Tribes attempted to fund of Tribal golf courses with tax exempt financing those efforts have been challenged.

### The Next Steps

Congress has a longstanding policy of encouraging Tribal economic development. I have provided information on the two foundational statutes that have furthered this goal in the past. Congress now has the opportunity to further this policy by enacting new legislation that serves this objective of economic self-sufficiency. I.R.C. § 7871 and relevant Treasury regulations<sup>7</sup> are the appropriate vehicles for amendments to resolve the ambiguities of the 1982 Act and clarify what Tribes can and cannot do with tax exempt financing.

An additional option to broaden a Tribe's economic development is to provide Tribes with a broader ability to issue private activity bonds. This would provide Tribes with another tool to drive economic development like state and local governments have used extensively.

Currently, Tribes can issue private activity bonds only within very narrow circumstances; in contrast, state and local governments have much broader ability to issue private activity bonds. The result is that although Tribes have less ability to generate revenue for government operations and programs for its citizens, they are unable to use a tool that is widely used to generate revenue by state and local governments.

Because of the short timeframe, I have not brought any proposed legislation with me today; however, I would be glad to work with the Sub-Committee's staff to develop legislation in this area. Consistent with the Congressional policy of encouraging Tribal economic development, I believe that any revision of the current statute should include the following elements:

1. Permit Tribes to utilize tax-exempt bonds to fund the same activities as state and local governments, thereby financing all essential government functions; and
2. Permit Tribes to utilize private activity bonds to support economic development.

Any amendment or other revision to the current statute will require consultation with Tribes. Within this conversation, the Tribes can share information learned from their economic development experiences, and can provide Congress, the Treasury Department and the IRS with valuable insights into the unique status and economic challenges faced by the Tribes. I look forward to those conversations.

Thank you for the opportunity to speak with you today.

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<sup>7</sup> Treas. Reg. Section 205.7871-1

**Advisory Committee on  
Tax Exempt and Government Entities  
(ACT)**

***Survey and Review of Existing Information  
and Guidance  
for Indian Tribal Governments***

**Lenor A. Scheffler and Robert L. Gips, Project Leaders**

**JUNE 8, 2005**

## TABLE OF CONTENTS

I. EXECUTIVE SUMMARY.....	3
II. PROJECT PROCESS .....	5
III. BACKGROUND .....	6
IV. RECOMMENDATIONS AND DISCUSSION.....	10
A. GUIDANCE RECOMMENDATIONS .....	10
B. WEBSITE RECOMMENDATIONS .....	13
V. CONCLUSION .....	16

## I. EXECUTIVE SUMMARY:

There are over 560 federally recognized Indian Tribes in the United States. Each Tribe has its own government. The Tribal Governments, their tribal members, tribal government staff, financial officers, internal and external accountants, and internal and external lawyers who work with them are the customers (the "ITG Customers") of the Office of Indian Tribal Governments ("ITG"). The resources available to Tribes varies considerably. There are relatively few Tribes with sufficient resources to afford expert staff and counsel regarding tax matters. A great number of Tribes are not able to hire tax experts and must rely on generalists. At the same time, most Tribes are still in the early stages of tribal economic development and guidance on tax matters is particularly important.

An additional consideration is that Tribes have a unique status within our federal system as sovereign entities. The Federal Government maintains a government-to-government relationship with Tribes. Only a small number of federal officials have had the opportunity to be educated about tribal history, tribal status and tribal sovereignty, partly because of the unique nature of Tribes and their governments, partly because of a past history of official neglect (sometimes benign and sometimes not), and partly due to Tribes' historical lack of political power. Tribal governmental status often is not well understood, and consequently, tribal tax status is not well understood. In addition, a need for clarification remains in a variety of areas.

The recent recognition by the IRS of the need for the ITG and the ensuing creation and staffing of the ITG have been significant steps forward in turning the corner on this history of neglect, and on the lack of understanding of tribal tax and related issues. The ITG has recognized the importance of basic principles of tribal sovereignty and tribal outreach and has made great strides in its short existence. This progress is due both to the ITG's recognition of tribal sovereignty, and to the personal efforts of key ITG staff. The ITG has been viewed by ITG Customers as a positive initiative. The ITG has improved the lines of communication between Tribes and the IRS. This in turn has helped lead to a deeper mutual understanding between the ITG and Tribes. Information developed by the ITG, and the availability of ITG representatives to meet with Tribes, has led to an increased understanding of the IRS' requirements and undoubtedly has led to increased voluntary compliance.

However, while the creation of the ITG has been a significant step forward in creating usable and useful information for Tribes and enhancing compliance opportunities, as the ITG itself recognizes, substantial work in this area is yet to be done. To aid in this effort, our project has involved the following:

- Review areas where guidance is currently inadequate, including areas where guidance has been under review or promised.
- Review areas where new guidance is needed.

- Recommend action in these areas.
- Identify and review current sources of web-based information for ITG Customers, and recommend ways to enhance presentation of this material to ensure greater understanding of the current IRS policy.

In the course of our work, it became apparent that current enforcement efforts by the IRS -- some of which are viewed by Tribes as unfair and at odds with how the IRS treats state and local governments -- coupled with a lack of progress on promulgation of past promised guidance, threatens to undermine the positive work that has been done by the ITG. Our recommendations address this issue in hopes of preserving and enhancing the progress that has been made to date by the ITG.



## **II. PROJECT PROCESS:**

The Project Group began by gathering and reviewing available IRS published materials relating to Indian Tribes, including relevant Internal Revenue Code provisions, regulations, revenue rulings, revenue procedures, private letter rulings and technical advice memoranda. We also reviewed other IRS guidance products provided by the ITG, including publications, newsletters and other information. The Project Group also reviewed all material posted on the ITG's website, ranging from FAQ's to listings of relevant information.

Following this data collection and review, the Project Group undertook a variety of interactive data exchanges with representatives of ITG Customers. E-mails were sent to a sampling of ITG Customers, explaining the Project's scope and seeking written and oral feedback. Follow up conference calls were conducted with ITG Customers. Interviews were conducted by the Project Group in person and by conference call with members of ITG staff, the Chief Counsel's office, the Office of Tax Policy at Treasury, TE/GE website representatives, and representative national and regional tribal organizations. Throughout this process, the Project Group made recommendations to the ITG regarding its ongoing work to address issues of website design, content and guidance products.

### III. BACKGROUND:

As noted in the Executive Summary, promulgation of guidance for Indian Tribes and other ITG Customers historically has not been a focus of the IRS. A number of factors may account for this situation. First, the unique status of Tribes as governments is not well understood. Second, the Internal Revenue Code is often silent on essential provisions, leaving greater gaps than might be found in other areas. Third, many Tribes historically have been impoverished, with little or no economic activity occurring on Indian lands, thus muting the demand for guidance.

Unlike local, state and federal governments, Tribes do not have a tax base to support their government operations and general welfare programs for their tribal members. Much of Indian country<sup>1</sup> is held in trust and not subject to taxation. Tribes must look to business development and excess revenues from business enterprises to fund governmental operations and general welfare programs. There has been a long-standing Congressional policy encouraging economic development in Indian country<sup>2</sup>, and over the past fifteen years an explosion in the pace of economic development has occurred for a number of Indian tribes. This is a welcome trend for communities that historically have been marred by some of this country's worst poverty, unemployment rates, lack of adequate housing, and poor infrastructure.

Unfortunately, the issuance of guidance by the IRS has not kept pace with the speed of economic development initiatives occurring in Indian country. This has been a source of frustration and even anger, cited to our Project Group during interviews and surveys. Tribal governments are hampered by inadequate guidelines available to assist Tribes in understanding the federal income tax consequences of using various business structures. For example, no guidance exists concerning the tax consequences of using a tribally-owned, state chartered limited liability corporation, or a tribally-owned, tribally chartered limited liability corporation, or a tribally-owned, tribally chartered corporation. Such basic questions are particularly important for Tribes, because tribal governments tend to be the primary source of economic development for Tribes, and hence the major source of employment and income opportunities for tribal members and their families.<sup>3</sup>

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<sup>1</sup> Indian country generally refers to territory under the jurisdiction of an Indian tribal government, and is statutorily defined at 18 U.S.C. §1151.

<sup>2</sup> See Indian Employment, Training and Related Services Demonstration Act of 1992 Pub. L. 102-477, Oct. 23, 1992, 106 Stat. 2302 (25 U.S.C. 3401 et seq.); Indian Gaming Regulatory Act Pub. L. 100-497, Oct. 17, 1988, 102 Stat. 2467 (18 U.S.C. 1866-1868; 25 U.S.C. 2701 et seq.); Indian Self-Determination and Education Assistance Act Pub. L. 93-638, Jan. 4, 1975, 88 Stat. 2203 (25 U.S.C. 450 et seq.); Native American Business Development, Trade Promotion, and Tourism Act of 2000 Pub. L. 106-464, Nov. 7, 2000, 114 Stat. 2012 (25 U.S.C. 4301 et seq.); and Native American Housing Assistance and Self-Determination Act of 1996 Pub. L. 104-330, Oct. 26, 1996, 110 Stat. 4016 (25 U.S.C. 4101 et seq.).

<sup>3</sup> Tribes, similar to other governments, exist in large part to provide services to the community -- direct services to constituents, infrastructure services and administrative services. The difference is that Tribes increasingly rely on economic development to fund those governmental services

The IRS has publicly stated for nearly a decade that initiatives to provide guidance in this area were under study or actively under study<sup>4</sup>, but there is a marked lack of tangible progress.

The nature of ITG Customers differs from that of other IRS customer groups. The tribal tax world is not a known environment like that encompassing exempt organizations or employees plans. There is not an army of specialists who know the clear parameters and can advise or advocate for their clients. Only a few Tribes have staff with professional tax experience, and there are literally only a handful of lawyers who have been able to focus their practices on tribal tax matters. The fact is that most Tribes are advised by generalists – whether lawyers, accountants, or tribal employees. This state of affairs underscores the need for the IRS to provide ITG Customers with clear and useful guidance. Furthermore, because there is a significant diversity of technical understanding among ITG Customers, the IRS must be able to meet the information needs of ITG Customers with both basic and advanced understanding of tax issues. As Congress has mandated legislatively in recent decades, the goal should be to help all Tribes achieve 'self determination' – the right and power to manage their own affairs and to exercise their sovereignty.

The IRS' mandate to provide such guidance to Tribes is also underscored by the unique trust relationship that the Federal Government has with Indian Tribes. This relationship includes trust asset management responsibilities, whereby the United States has the responsibility of acting as trustee for vast amounts of Tribal assets and individual tribal members' assets. This fiduciary responsibility has, to the great discredit of our country, been breached for over a hundred years; Cabinet officials have repeatedly been held in contempt of court for this breach in recent years.<sup>5</sup> This trust responsibility also extends to the more inchoate responsibilities of the Federal Government to act on behalf of Tribes.<sup>6</sup> The trust responsibility forms an additional backdrop through which Tribes view the IRS's actions, and against which the IRS's actions will be measured.

Within this atmosphere of increasing Tribal economic development, and lacking guidance from the IRS, the general view of many ITG Customers that were interviewed

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(supplemented with tribal taxes and other fees if available), while states and municipalities generally rely on their larger land and population bases to assess taxes (income, sales and property) to support services, supplemented by other fees and its own economic development initiatives. The need for Tribes to self-fund governmental services has accelerated as federal funding for Tribes has come under greater pressure in recent years.

<sup>4</sup> See the general discussion of the history of such initiatives at pp. 10-11.

<sup>5</sup> See *Cobell v. Norton*, U.S. District Court declaring Interior's conduct in managing trust assets and responses to class action suit as "the most egregious governmental misconduct it has ever seen". 2002 WL 163465 at \*35.

<sup>6</sup> See generally F. Cohen, Handbook of Federal Indian Law 220-228 (1982) (Cohen). *United States v. Mitchell*, 463 U.S. 206, 225, 103 S.Ct. 2961, 2972, 77 L.Ed.2d 580 (1983); *Tulee v. Washington*, 315 U.S. 681, 684-685, 62 S.Ct. 862, 864, 86 L.Ed. 1115 (1942); *Cherokee Nation v. Georgia*, 5 Pet. 1, 17, 8 L.Ed. 25 (1831)

was a sense of frustration and even anger at the slow pace of IRS follow-through on existing guidance projects.<sup>7</sup> These feelings were heightened by the belief that while the IRS has failed to deliver promised guidance, it has been seen to be increasingly focused on enforcement. New resources are perceived to have been devoted to enforcement efforts, rather than delivery of the promised guidance. This perception is only reinforced by current ITG work plans and overall TE/GE new hiring which is focused on enforcement efforts, and recent announcements regarding enforcement efforts.<sup>8</sup>

We learned from our discussions with TE/GE staff, Chief Counsel's Office and Treasury that there are several factors which underlie the slow pace of producing new guidance. These include: lack of resources; the complexity of issues presented; concern about precedential effect in seemingly unrelated areas; and the fact that the TE/GE group is only one of the relevant members of the IRS working groups that must ultimately reach consensus on new guidance. It is clear that new guidance will involve complex considerations and will require careful deliberation.

Nonetheless, we think that it is equally important for TE/GE to recognize the frustration felt within Tribes over such delays, which is heightened by a sense among ITG Customers that (i) the IRS is increasingly focused on enforcement rather than guidance, and (ii) what little recent guidance has been issued has been perceived by ITG Customers as unfair to tribal governments (because either the IRS does not understand tribal governments or it wants to treat them as non-profit entities and not true governments, e.g., treating tribes differently than governments that construct and operate golf courses and hotels with tax-exempt financing).

Furthermore, some interviewees, including influential tribal advocates, expressed concern that the consultation process is merely a façade, and that "compliance check" meetings currently being conducted by ITG are thinly disguised fishing expeditions for enforcement opportunities. More fuel is added to these fires by the lack of a signed consultation policy.

These experiences and this perception undermine the good work that ITG has done in its first few years of existence.

The ACT thus believes that a renewed emphasis on promptly completing existing guidance projects is critical and in the best interests of both Tribes and the IRS. The ACT also believes that such an emphasis is inherent in the trust relationship. We believe further that greater transparency in the process of creating guidance, and

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<sup>7</sup> In addition to the discussion of the history of promised guidance regarding the tax consequences of various legal structures for tribal economic development entities *infra* at pp. 10-11, see also discussions *infra* at p. 11 regarding promised guidance regarding tribal trusts and at p. 12 regarding lack of guidance on tax exempt tribal financings.

<sup>8</sup> See *Bond Buyer, v. 352*, April 28, 3005, 2005 WLNR 6999635 (discussing IRS announcement of plans to institute a dozen or more new examinations of Tribes to see if any transactions involved abusive arbitrage devices).

greater understanding of the issues faced by the IRS in creating such guidance, is necessary. Accordingly, the ACT is making several recommendations regarding these aspects of the guidance process.

The ACT also believes that continued focus on dissemination of existing information is important. ITG has made a good start through the ITG web site, and we believe this is an area meriting further focus and work.

#### IV. RECOMMENDATIONS AND DISCUSSION:

##### A. Guidance Recommendations

As discussed above, there are several core subject matter areas where ITG Customers have been promised but not received guidance. These include the following:

**Recommendation #1: Issue guidance regarding the federal tax treatment of different legal structures used for tribal businesses and economic development entities.** As noted earlier, Tribes generally do not have tax revenues adequate to support government operations, and many tribal members depend on tribal general welfare programs for housing, health care and elder care, as well as, tribal businesses for job training and employment. Excess revenues from tribal business operations are a critical source of funding for tribal governmental programs, but guidance on the income tax consequences of alternate business structures has been minimal. The IRS has provided very limited guidance in the past on this matter, despite the fact that further guidance on this matter has been a matter of official study and consideration for nearly a decade. As noted earlier, tribal governments are the primary engine for economic development in Indian country, lending urgency to the need for this guidance.

**Observation:** Limited guidance exists at this point. Tribes are not taxable entities, though most tribal income, when distributed to tribal members, is subject to individual income taxation.<sup>9</sup> The IRS has ruled that if a Tribe forms a wholly owned corporation under state law, the corporation is subject to federal income tax.<sup>10</sup> It is also clear that Tribes may form wholly owned, federally chartered "Section 17" corporations under the Indian Reorganization Act, 25 U.S.C. §465, and that such corporations are not subject to federal income tax.<sup>11</sup> Section 17 corporations, however, can take months to establish, their charters cannot be amended without federal approval, and their status is confusing to third parties. Tribes urgently need guidance on the IRS's view of the income tax consequences of Tribes conducting business through wholly owned corporations and limited liabilities companies formed under tribal law, and on the status of wholly owned limited liability companies formed under state law.

For ITG Customers, the length of time that this issue has been under consideration, without issuance by the IRS of precedential guidance, is a source of extreme frustration. In the preamble to the final regulations on the tax classification of business entities in 1996, the IRS noted that the Treasury Department and the IRS were considering the status of wholly owned, tribally

<sup>9</sup> Rev.Rul. 67-284, 1967-2 C.B. 55.

<sup>10</sup> Rev. Rul. 94-16., 1994-1 C.B. 19.

<sup>11</sup> Rev.Rul. 81-295, 1981-2 C.B. 15; *see also, Mescalero Apache Tribe v. Jones*, 411 U. S. 145, 157 n. 13 (1973). These federal law corporations are referred to as Section 17 corporations because they are incorporated pursuant to Section 17 of the Indian Reorganization Act.

chartered corporations.<sup>12</sup> Subsequently, in 2001, the Treasury Department and the IRS agreed to resolve questions regarding such tax treatment. This matter has been on the IRS work plan for years, with no apparent progress toward resolution.

Discussions with ITG, Chief Counsel's Office, and Treasury indicated that this was considered to be a complex matter involving the possible creation of precedent for other governmental entities. Given the unique status of Indian Tribes, the Project Group is uncertain why guidance in this area necessarily needs to be considered precedent-setting in other areas, and we urge further consideration of the weight granted to this concern.

Additionally, the Project Group believes that this area might be one where, if comprehensive guidance is not likely to be readily forthcoming, the IRS should consider issuing limited guidance addressing more discrete elements of the various possible structures that Tribes might use for economic development.

The continued absence of guidance in this critical area hampers vitally needed tribal economic development.

**Recommendation # 2: Issue guidance regarding tribal trusts.** The IRS has provided limited guidance to Tribes on the issue of the tax treatment of tribal trusts. Revenue Procedure 2003-14 provided guidance on the income tax consequences applicable to trusts established by Tribes using gaming revenues for the benefit of minors and incompetent persons. That Revenue Procedure also requested public comment and set out a no-rule position on private letter ruling requests while the comments were being considered. Significant public comments were received. However, no action has been taken on the comments received, and because of the Service's no-rule position, Tribes are not able to get any guidance whatsoever, even in the form of private letter rulings.

**Observation:** Despite the fact that Rev.Proc. 2003-14 addressed minor and incompetent trusts, the no-rule issued by the IRS was drafted so broadly that it encompasses most other trust rulings a tribe might request, including those related to adults. Many Tribes have been forming a variety of trusts over the past few years, and the IRS's inaction is another source of frustration for Tribes. Additionally, the inaction of the IRS on the comments received to date and the no private letter ruling position have created an environment in Indian country for tax avoidance schemes and unscrupulous promoters. Such an environment undermines the IRS's current emphasis on curtailing abusive schemes. As promised, comments on Rev. Proc. 2003-14 should be incorporated into a new Revenue Procedure, and in the interim, the no-rule position should be rescinded

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<sup>12</sup> See Treas.Dec.869, 61 Fed.Reg. 66585 (Dec. 1, 1996)

by the IRS. Such action will further the IRS's stated goal of discouraging and deterring misuse of government entities by third parties.<sup>13</sup>

**Recommendation # 3: Issue guidance regarding what constitutes an "essential governmental function" for purposes of tribal government issuance of tax-exempt debt.** This issue was the subject of an ACT report last year entitled *Tribal Guidance and Policy*.<sup>14</sup> As that ACT Report noted, governmental bonds issued by Tribes are an essential tool for creation of tribal infrastructure. Tribes may not issue private activity bonds, but tribal governments may issue tax-exempt bonds for "essential governmental functions." Unfortunately, the meaning of that term remains unclear. Without reprising the issues addressed in that Report here, these issues continue to fester, and frustration within the tribal governmental community continues to grow as the IRS has significantly expanded the number of Tribes under audit as issuers or borrowers of tax-exempt debt.

**Observation:** When amending the Indian Tribal Government Tax Status Act in 1987,<sup>15</sup> the Report of the House Committee stated that "the term essential governmental function does not include any governmental function that is not customarily performed (and financed with governmental tax-exempt bonds) by States and local governments with general taxing powers."<sup>16</sup> As noted in *Tribal Guidance and Policy*, since 1987 no regulations have been issued on this point, nor has further guidance been provided, other than Field Service Advice 2002412 (the "FSA") issued on November 22, 2002. This FSA determined that although there were 2,645 publicly owned, municipal golf courses in the country, a financing of a tribally owned golf course would not qualify as an essential governmental function, and the IRS has commenced audits of at least two tribal issuances of tax-exempt bonds intended to finance public golf courses.<sup>17</sup> Within the tribal government community, this FSA and audits continue to cause consternation and a sense of bias. And while states and cities routinely issue tax-exempt debt for hotels and convention facilities, the IRS has commenced initial audit proceedings regarding several recent instances of conduit bonds issued by non-tribal entities for the benefit of Tribes constructing hotel and meeting facilities in Indian country.<sup>18</sup> These audit actions collectively have had a perhaps intended chilling effect on issuance of tax-exempt tribal debt, and at the

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<sup>13</sup> One of the four "key enforcement priorities" in the IRS Strategic Plan is to "discourage and deter non-compliance within tax-exempt and government entities and misuse of such entities by third parties for tax avoidance and other purposes." IRS Strategic Plan, <http://www.irs.gov/newsroom/article/0,,id=125266,00.html>.

<sup>14</sup> *Tribal Guidance and Policy*, ACT Report, June 9, 2004. See

<http://www.irs.gov/charities/article/0,,id=98353,00.html> at 97 *et seq.*

<sup>15</sup> Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, 96 Stat. 2608, 256 U.S.C. § 7871.

<sup>16</sup> H.R. Rep. No. 391 at 1139.

<sup>17</sup> See Bond Buyer, *supra*.

<sup>18</sup> *Id.*



same time have reinforced sentiments of bias among Indian tribal governments and their advocates.

*Comment:* We recognize that actions in this area by the IRS are circumscribed by the fact that the best solution to this issue – issuance of regulations by Treasury – is not within the IRS' control; and by the fact that enforcement actions are proceeding. But guidance in this area has reverted to guidance by field examination and audit. Enforcement is not a substitute for guidance, and the ACT believes that Tribes need and deserve guidance promptly.

**Recommendation #4: Provide more consistency, transparency and communication to the tribal government community and leading advocates regarding the guidance process.** Through our discussions with ITG representatives, Chief Counsel's Office, and Treasury, the Project Group became more aware of some of the limitations placed upon the ITG and the TE/GE group in attempting to provide guidance on some of the foregoing issues. We are aware of the fact that many issues require input from groups outside TE/GE, including other subject matter groups within the IRS, and from agencies outside the IRS. Despite these issues, the Project Group recommends that ITG, Chief Counsel, and the TE/GE group redouble their efforts to gain cooperation needed to address the foregoing guidance issues. At the same time, we believe that efforts to explain the guidance process to ITG Customers – including both procedural issues and substantive concerns – will be helpful to both the IRS and ITG Customers, and are worth undertaking. This can be done through attending and speaking at one or two national tribal gatherings, and through an annual invitation to tribal advocates to meet with relevant IRS officials in Washington for more informal discussion of open issues.

*Observation:* As noted before, even though ITG has done an excellent job of reaching out to Tribes, there is a perception among ITG Customers that the ITG has little control or power over the guidance process, and that the process of guidance formulation is a black hole of uncertainty. There is minimal awareness, at best, of who is responsible for tribal guidance, where various projects stand, what the timetables for completion are, and what some of the competing substantive concerns of the IRS might be. While discussions with Chief Counsel revealed that several individuals tend to be involved in most tribal guidance decisions, this is not generally known. We would recommend that several people within Chief Counsel's Office be assigned the responsibility of developing familiarity with Indian law and serve as liaison for tribal guidance efforts. Treasury has an individual who serves as a liaison for guidance efforts. This is commendable.

## **B. Website Recommendations**

ITG's website is an important source of information for Indian country. We like the fact that it is an independent landing page, reflecting ITG's logo. We understand from meetings with those responsible for the page that ITG has a limited number of

options in changing the layout of the page. We also understand that this is due to a desire within the IRS for consistency of layout.

The widely dispersed geographic nature of Indian Tribes, and the fact that the ITG Customers are not served by a large corps of tax specialists illustrates the importance of the website for information dissemination. It also explains why the website needs to be user-friendly, comprehensive, and as current as possible. ITG's website reflects considerable past work and thought, but could be improved in several ways.

**Recommendation # 5: Develop a comprehensive, easily-locatable, and cross-referenced set of all statutes, regulations, revenue rulings and other guidance related to Indian tribal governments.** As of this writing, there remains no single, comprehensive and accurate source of the IRS' tribally-related materials that can be easily referenced by tribal officials and practitioners. Ideally, such a source should be compiled in two, hyper-linked formats: first, a listing of relevant materials by statute, regulation, revenue ruling, revenue procedure, field guidance, private letter rulings, and so on, listed from most precedential to least, with a brief summary description of the subject matter of each document; and second, by subject matter.

**Observation:** There are literally only a handful of tribal tax professionals who have easy access to the full panoply of IRS rulings affecting Tribes. ITG Customers are not likely to subscribe to tax publications or have access to specialized materials. While there are many helpful FAQ's on the website, there is a great need for one place where ITG Customers can easily find all relevant materials. The current ITG website aggregates some of this material, but the site is incomplete, and hard to locate. To find the ITG page that only partially aggregates these materials, one must navigate to [irs.gov/tribe](http://irs.gov/tribe), go to "related topics", click there on "more topics", and scroll down to "regulations and rulings" – a confusing set of steps that is not intuitive. Instead, we recommend that, as is done on the Tax Exempt Bond Community landing page, there be a permanent link to 'Published Guidance' on ITG's landing page.

**Comment:** This recommendation has been discussed since fall 2004 with ITG, which agrees with the concept and has been working to gather and organize relevant materials for posting. We encourage ITG to complete this work as quickly as possible and post it in the recommended format.

**Recommendation # 6: Post on the ITG website a detailed explanation in plain English of the hierarchy of guidance, in terms of binding precedential value.** We envision this explanatory piece as a sort of "Layman's Guide To Guidance" or "Guidance Matrix" or "Guidance Flow Chart" accompanying the cross-referenced set of statutes, regulations and other guidance discussed in Recommendation #5, with such materials explaining, for instance, the difference between revenue rulings and private letter rulings, which guidance is binding, and which advisory.

Observation: Due again to the number of website ITG Customers who are not tax professionals, such an explanation would be extremely helpful, and we believe that its creation should not require extensive resources.

**Recommendation # 7: Consider creative ways to update and improve the various FAQs that appear on the website.** There are numerous FAQ sections within the website, which contain a wealth of information for ITG Customers who are trying to understand issues relating to Tribes and tribal taxation. Much of this information was created a number of years ago, upon the inception of the ITG. Some of the information is internally inconsistent (for example, different definitions of items in various FAQs), some information is outdated, and some information is factually incorrect. In addition, hyper-links need to be increased. In an ideal world, there might be staff within ITG available to review, revise and update the FAQs. If, however, this is not the case, alternative approaches should be considered for assistance. One promising possibility would be to work with one or several law schools that have Indian law programs, and ask for student volunteer assistance, coordinated through law professors, to revise and modernize the FAQs. The ITG would then be tasked with reviewing and finalizing new or revised content, but would be saved a good deal of labor.

Observation: Members of the Project Group have had initial conversations with Indian law professors at several law schools, and believe that there would be significant interest in such a project.

**Recommendation #8: Reorganize ITG's landing page so that the topics addressed in the body of the page serve as guidelines to the places where relevant content can be found.** As currently organized, there is no apparent rationale to the topics on the landing page, which appear to cycle on and off with the most recent developments being listed, and earlier developments being displaced accordingly. Instead, we recommend that current developments be listed under a heading with that title; that published guidance be similarly listed under a heading with that title; and so on.

Observation: The Project Group believes that a good template for such organizational change can be found in the Tax Exempt Bond Community landing page, and this should be emulated.

**Recommendation # 9: Provide a direct link to ITG's web page from the general IRS landing page.** The rationale for such a link is fairly straightforward. Most people trying to access IRS tribal information do not and will not know of the ITG web page. Most people landing on the main IRS web page most likely will not know that Indian Tribal Governments are part of "Government Entities". Others may search from the main IRS landing page in the search box. With three separate samplings, ITG's website is not one of the initial items that came up. Specifically, if "Indian Tribes" is typed in the search box, there are 376 results that include FAQs but none take you straight to ITG's web page. If "Indian Tribal Government" or "Tribal Government" are typed into the search box on the main IRS landing page, there are 500 results to search through and

no link to the ITG. If "Indian" is typed into the search box on the main IRS landing page, there are 35 results and, again, none take you to the ITG's web page. Therefore, having a direct link to the Indian Tribal Government page would be a tremendous tool for ITG Customers.

*Observation:* The ACT believes that the rationale for providing this link is similar to that which justified adding a similar link on the IRS.gov landing page to the tax exempt bond web page. Additionally, revising the IRS.gov landing page to list "Federal, State, Local and Indian Tribal Government Entities" would be more helpful than just "Government Entities." This is an easy short-term solution.

**Recommendation # 10 : Allow more creativity in the design of the ITG web page.**

The recommendations of the ACT regarding ITG's web site layout have been constrained by what we have been told are limits on the appearance of the ITG's web pages intended to promote uniformity in appearance of all IRS web pages. While we understand the desire for uniformity, we believe that the needs of ITG Customers differ so greatly from the needs of users of other IRS web pages aimed at individual taxpayers, that it makes more sense to allow greater creativity in design of ITG's web page. We believe that the likely outcome will be web pages better designed to meet the needs of the different taxpayer groups, and this in turn will promote greater use of the web pages with the concomitant benefits of increased, low-cost information dissemination and greater compliance.

*Observation:* The concern for uniformity, we believe, should not stifle creativity; and one could still envision a system where deviations from the current page design need central approval, in order to avoid gross inconsistencies. If there is concern about the effect of undertaking such a change all at once, an alternative would be to allow experimentation by one or two relevant groups, including ITG.

## V. CONCLUSION

We appreciate the time and support of ITG staff, Chief Counsel's office, the Office of Tax Policy at Treasury, TE/GE website representatives, as well as the time and comments of all those Tribal representatives and advocates who shared their views with us.

The recommendations and views set forth herein are offered in the belief that the good work to date that has been accomplished in creating ITG will be enhanced through provision to Tribes of prompt promised guidance and improvements to the ITG website. These steps will enhance compliance opportunities and improve the relationship between ITG and ITG Customers.