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

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## Report of Recommendations



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Tax Exempt and Government Entities  
(ACT)

II. Tribal Advice and Guidance Policy

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## Introduction<sup>1</sup>

A major obstacle to the ability of tribal governments to implement long-term, self-sustaining economic development projects are the many restrictions within the Indian Tribal Governmental Tax Status Act of 1982 (hereinafter, "the Act"), 25 U.S.C. §7871. The Act contains limiting provisions that prohibit tribal governments from issuing tax-exempt bonds except for the performance of "essential governmental functions." The federal government's failure to understand and accommodate the developmental status of many tribal economies in defining "essential governmental function" actually defeats many tribes' ability to operate as a fully functioning governmental entity on an equal footing with state and local governments. The Act discourages the development and acquisition of the most basic elements of infrastructure taken for granted off the reservation, but so lacking and desperately needed by many tribal communities in virtually every state of the Union.

In order to understand how current federal Indian policies, although well-intended have, in application, fallen short in promoting sound tribal economic development, the following elements are considered herein:

- History of Federal Indian Policy;
- Unique Aspects to Tribal Economic Development; and
- The Indian Tribal Governmental Tax Status Act of 1982 and its Implementation by the Treasury Department and the IRS.

Finally, this report will provide recommendations for addressing the underlying problems of current law that currently frustrates the economic development of tribes; although a Congressional fix may ultimately be the best solution<sup>2</sup>.

### I. Brief History of Federal Indian Policy

Since our Nation's inception, the federal government's treatment of Indian tribes has run a complex and tumultuous course marred by inconsistencies and extremes. Political historians have grouped these stages into the distinct legal, political, and historical eras described below.<sup>3</sup> Any adequate assessment of the current regime

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<sup>1</sup> ACT member Perry Israel did not materially participate in the preparation of this report.

<sup>2</sup> The Project Group interviewed many IRS personnel, tax attorneys, and other officials working for or on behalf of tribal governments. The interviewees consistently maintain that the best solution for the problem facing tribal governments issuing tax-exempt bonds is for a Congress to amend the Act by defining the term "essential governmental functions" or allow tribal governments to issue private activity bonds. The interviewees also generally perceive that IRS officials want either the Treasury Department to develop regulations or desire Congress to amend the Act. Attorneys who work for tribal governments are also somewhat at odds with their recommendations. On one hand, they desire an administrative fix for the term "essential governmental functions" but they are fearful that if the IRS or Treasury Department attempts to administratively fix the problem, then Congress will not amend the Act. But they also are concerned that if Congress attempts to amend the Act, they perceive that the IRS or Treasury Department will not administratively fix the problem.

<sup>3</sup> See *American Indian Law in a Nutshell*, William C. Canby, Jr; Felix S. Cohen's *Handbook of Federal Indian Law*, 1982 Edition.

requires a working knowledge of these eras in order to ensure that prospective goals, policies, and practices achieve common national goals while avoiding exacerbation of past mistakes.

- Establishment of Federal Role - (Colonial times to 1820): This period witnessed the birth of the United States and the establishment of relationships among Indian tribes, European nations, and the United States. The first Congressional acts concerning Indians were passed to regulate commerce between Indians and non-Indians and to manage land exchange issues.
- Indian Removal and Establishment of Reservations - (1820-1887): This was a time when the federal government dealt with the "Indian problem" by removing en masse virtually all tribal peoples further and further westward to established "reservations" in an effort to minimize contact between tribes and non-Indian society as the influx of non-Indian settlers steadily encroached upon ancestral tribal lands.
- Allotment and Assimilation - (1887-1934): This federal policy was championed by proponents of assimilation who believed that Indians would be treated in the most socially responsible and honorable manner by integrating them, not as members of a tribal community but as individuals, into mainstream non-Indian American society. In 1887, Congress approved the General Allotment (Dawes) Act that, for the most part, divided reservation lands into separate parcels that were then allotted to individual Indian males. The allotment policy, while viewed as the most socially responsible plan for dealing with the Indians, also conveniently served to open up vast surpluses of reservation lands for non-Indian settlement. Many Indian reservations that were allotted became (and often remain today) a checkerboard of lands owned by both non-Indians and Indians, with a concomitant hodge-podge of governmental jurisdiction often disputed by both parties.
- Indian Reorganization - (1934-1953): Based on the dismal failure of the allotment policy, which was well documented across the country, Congress attempted to reverse the devastating effects of allotment. Congress placed reservation lands into trust status and enacted a system of federal oversight governing the alienation of these lands. Economic development and education became funding priorities, and tribes were allowed to adopt constitutions and corporations, many of which used federal or state governmental models.
- Termination - (1953-1968): Reorganization of the Indians into cohesive tribal communities was then abandoned in favor of termination. During this era, the federal government "terminated" its official legal recognition of 109 tribes and extinguished the Indian peoples' status as wards of the government. Congress also legislated state control over Indian country in several states by enacting Public Law 280 that provided for state civil and criminal jurisdiction over reservation territory.

- Self-Determination - (1968-present): The civil rights movement of the 1960's led to the re-examination by the federal government of the termination policy. In a 1970 special message to Congress, President Richard M. Nixon called for a new federal policy of "self-determination" for Indian nations. Thereafter, Congress enacted numerous laws that ostensibly supported self-determination and economic development for Indian tribes, including the Indian Tribal Government Tax Status Act of 1982.

"Self-determination" is a federal policy that attempts to promote equitable government-to-government relations between the federal government and Indian tribes, to encourage tribal self-government, and to support the development of tribal economies.<sup>4</sup> This policy has received official support through both Congressional<sup>5</sup> and Presidential actions,<sup>6</sup> as indicated by the following remarks by President Ronald Reagan in his January 24, 1983 American Indian policy statement:

. . . Instead of fostering and encouraging self-government, [f]ederal policies have by and large inhibited the political and economic development of the tribes. Excessive regulation and self-perpetuating bureaucracy have stifled local decision-making, thwarted Indian control of Indian resources, and promoted dependency rather than self-sufficiency . . . The economics of American Indian reservations are extremely depressed with unemployment rates among the highest of the country. Indian leaders have told this Administration that the development of reservation economies is their number one priority. Growing economies provide jobs, promote self-sufficiency, and provide revenue for essential services . . . Tribes have had limited opportunities to invest in their own economies because often there has been no established resource base for community investment and development. Many reservations lack a developed physical infrastructure including utilities, transportation and other public services . . . The federal government's responsibility should not be used to hinder tribes from taking advantage of economic development opportunities . . . A full economic recovery will unleash the potential strength of this private sector and ensure a vigorous economic climate for development which will benefit not only Indian people, but all other Americans as well.<sup>7</sup>

<sup>4</sup> See Special Message to the Congress on Indian Affairs issued by Richard M. Nixon, July 8, 1970, and American Indian Policy issued by Ronald Reagan, January 24, 1983; 19 Weekly Comp. Pres. Doc. 98.

<sup>5</sup> See Indian Self-Determination and Education Assistance Act, 25 U.S.C. §§450 et seq.; Indian Child Welfare Act of 1978, 25 U.S.C. §§1901-1963; Indian Financing Act, 25 U.S.C. §§1451 et. seq.; Indian Tribal Governmental Tax Status Act of 1982; 26 U.S.C. §7871; Indian Gaming Regulatory Act of 1988, 25 U.S.C. §§2701-2721; numerous restoration acts for terminated tribes; and various environmental laws that recognize tribal authority.

<sup>6</sup> *American Indian Policy* issued by Ronald Reagan, January 24, 1983; 19 Weekly Comp. Pres. Doc. 98; *Statement on Signing the Indian Self-Determination and Education Assistance Act* issued by Ronald Reagan, October 5, 1988, 24 Weekly Comp. Pres. Doc. 1268; *Statement Reaffirming the Government-to-Government Relationship Between the Federal Government and Indian Tribal Government* issued by George Bush, June 14, 1991, 27 Weekly Comp. Pres. Doc. 783; *Consultation and Coordination with Indian Tribal Governments* issued by William J. Clinton, May 14, 1998, Executive Order 13084; *White House Conference on Building Economic Self-Determination in Indian Communities* issued by William J. Clinton, August 6, 1998, 34 Weekly Comp. Pres. Doc. 1576.

<sup>7</sup> *American Indian Policy* issued by Ronald Reagan, January 24, 1983; 19 Weekly Comp. Pres. Doc. 98.

(Emphasis added.)

## II. Unique Aspects to Tribal Economic Development and the Need for Revenue Generation

Historically, Indian tribes existed as separate and distinct cultures and races from one another. Existing prior to federal, state, and local governments, each tribe developed and maintained its own internal governmental structure, each unique in form, size, land-base, and in the natural resources available to the tribal community. Resources were managed to commensurate with the needs of the tribe.<sup>8</sup> Many of these original tribal governments still exist today, although most have modernized under the pressure of historical and political changes brought by the dominant culture.

Today, there are 562 federally-recognized Indian tribes in the United States.<sup>9</sup> Legal developments in federal Indian law have left tribal governments with certain governmental functions and authority as quasi-sovereign entities that co-exist with federal, state and local governments.

As such, tribal governments have retained some inherent governmental authority, such as the power to raise revenues through taxation,<sup>10</sup> gaming,<sup>11</sup> natural resource development and energy projects,<sup>12</sup> and other economic ventures. They have also regained certain powers once lost, although on a somewhat limited basis. Powers such as criminal and civil jurisdiction over Indian and non-Indians were restricted or extinguished during historical eras limiting tribal sovereignty. Like all governments, tribal governments use their revenues to provide essential governmental services and to promote economic development for their citizens,<sup>13</sup> residents and visitors. In fact, the U.S. Supreme Court in *Merrion v. Jicarilla Apache Tribe*,<sup>14</sup> held that all residents of Indian country include those persons (Indians and non-Indians, alike) who reside within the exterior boundaries of an Indian reservation "benefit from the provision of police protection and other governmental services, as well as from 'the advantages of a civilized society' that are assured by the existence of tribal government."<sup>15</sup> Further, the Court stated that a tribal government's power to tax is derived, not from its authority as a landowner (e.g. the power to exclude non-Indian from tribal land), but from its

<sup>8</sup> The sovereign status of tribal governments have been recognized and reaffirmed time and time again by the U.S. Supreme Court. As Chief Justice John Marshall stated "The Indian nations [have always been considered as] distinct, independent political communities, retaining their original natural rights, as the undisputed possessor of soil, from time immemorial . . ." *Worcester v. Georgia*, 31 U.S. (6 Pet.) 505, 559 (1832). See also *U.S. v. Lara*, 204 WL 826057 (U.S.)

<sup>9</sup> Federal Register, 12-05-03; Vol. 68, No. 234.

<sup>10</sup> See *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982); and *Kerr-McGee v. Navajo Tribe*, 417 U.S. 195 (1985).

<sup>11</sup> See Indian Gaming Regulatory Act of 1988, 25 U.S.C. §§2701-2721.

<sup>12</sup> Natural resource development includes coal, natural gas, oil, timber, water, etc.

<sup>13</sup> Citizens of a tribal government are generally members of the Indian tribe. See *Morton v. Mancari*, 417 U.S. 535 (1974). (The U.S. Supreme Court determined that membership in an Indian tribe is a political distinction not racial).

<sup>14</sup> 455 U.S. 130 (1982).

<sup>15</sup> *Id.* at 138.

authority as a legitimate sovereign to control economic activity within its territorial jurisdiction.

Although the federal government has tried to promote tribal self-determination, the status of tribal governments as "quasi-sovereign" entities has become self-defeating. The primary reason for this predicament is the inherent assumption in federal law that all governments, including tribal governments, possess or can easily acquire the fundamental infrastructure needed to provide basic services to its citizens, residents and visitors. In reality, many tribal governments, still suffering from the impacts of historical federal policies, lack the ability to provide the most basic infrastructure that most U.S. citizens take for granted, such as passable roadways, affordable housing, and the plumbing, electricity and telephone services that come with a modern home.

In fact, most Indian tribes have an economy that is on par with most third world countries.

According to the U.S. Census Bureau, approximately 20% of American Indian households on reservations lack complete plumbing facilities, compared to 1% of all U.S. households. And about 1 in 5 American Indian reservation households disposed of sewage by means other than public sewer, septic tanks, or cesspool.<sup>16</sup>

Moreover, historical and social circumstances have created a climate in which Indian populations living within Indian territories generally have extremely low socio-economic factors, including low educational achievement, high unemployment<sup>17</sup>, high poverty<sup>18</sup>, and low per capita income.<sup>19</sup> Overall, the lack of adequate infrastructure and low socio-economic factors are unattractive to business development on Indian reservations. And without resolution of these problems, the problems will continue.

Many tribal governments rely on state and federal funds to mitigate these problems. But the funds are insufficient to address the myriad responsibilities facing tribal governments. Similarly, gaming does not provide sufficient funds to meet the needs of all tribal governments. It is a general misconception that all Indian tribes are rich and have gaming, since more than a majority of all Indian tribes are without gaming of any kind.<sup>20</sup> Therefore, if the creation of self-sustaining revenue sources is the goal, tribal governments must be permitted to issue tax-exempt bonds, the bread and butter of most state and local governments treasuries. Unfortunately, the current statutory scheme of the Indian Tribal Governmental Tax Status Act and the implementation of the Act do not allow tribes to issue tax-exempt bonds. It is odd that self-determination has

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<sup>16</sup> See Bureau of the Census, Statistical Brief, Housing of American Indian on Reservations – Plumbing (April 1995).

<sup>17</sup> The general U.S. population has unemployment rate of 5.8%, compared to 13.6 percent of the workforce on Indian reservations. See U.S. Census Bureau 2000.

<sup>18</sup> The general U.S. population has a poverty rate of 12.38%, compared to 25.67% for American Indians. See U.S. Census, 2000.

<sup>19</sup> The general U.S. population has a per capita income of \$21,587.00, compared to \$12,893.00 for the American Indians. See U.S. Census 2000.

<sup>20</sup> Total number of federally recognized Indian Tribes: 562. Number of Tribal Governments engaged in gaming (Class II or Class III): 224. See National Indian Gaming Association website, [www.indiangaming.org](http://www.indiangaming.org)



been a U.S. Presidential policy and a goal of Congress since the late 1960s, but the Indian Tribal Government Tax Status Act as currently written does not fully reflect or advance this federal policy.

### III. Indian Tribal Governmental Tax Status Act of 1982 and Its Implementation by the Treasury Department and the IRS

In 1982, Congress passed what was perhaps the most important piece of tax legislation to impact the federal governments treatment of Indian tribes for taxation purposes -- The Indian Tribal Governmental Tax Status Act.<sup>21</sup> Prior to this time, federal law was unclear on how tribal governments, and their subdivisions, were treated for various federal tax purposes.<sup>22</sup>

In keeping with the Self-Determination era of federal Indian policy, the Act attempted to treat tribal governments equally to state and local governments for certain tax purposes. It did not, however, achieve the objective of placing these governments on equal footing to one another.

The Act allowed a deduction from federal income tax for taxes paid to Indian tribes; allowed charitable contributions to tribal governments to be deductible for income, estate and gift tax purposes; and allowed an exemption for tribal governments for various federal excise taxes. But the Act also prohibiting tribes from issuing tax-exempt private activity bonds<sup>23</sup> and limited the ability of tribal governments to issue tax-exempt governmental bonds by allowing them to be issued only for activities that can be classified as "essential governmental functions."

Although the Act itself did not define the term, a Congressional Conference Committee Report stated that "essential governmental functions" includes projects like "schools, streets, and sewers." The report also stated that tribal governments could not issue "private activity bonds" including industrial development bonds. In short, when

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<sup>21</sup> The Indian Tribal Governmental Tax Status Act of 1982, (Title II of Pub. L. No. 97-473, 966 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1983-1 CB 510, 511, §1065 of the Tax Reform Act of 1984, 1984-3 (Vol. 1) Cumulative Bulletin 556, made permanent the rules treating Indian Tribal governments, or subdivisions thereof, as states. See also Revenue Procedure 86-17 and Revenue Ruling 86-44. The term "Indian Tribal government" is defined under IRC§ 7701(a)(40), as amended, to mean the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, that is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions. This definition is used to comprise the federally recognized list as determined by the Bureau of Indian Affairs. The Indian Tribal Governmental Tax Status Act of 1982, (Title II of Pub. L. No. 97-473, 966 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1983-1 CB 510, 511]).

<sup>22</sup> See Revenue Ruling 67-284 (Indian tribes are not a taxable entity.); Revenue Ruling 81-295 (Federally-chartered corporations wholly owned by an Indian tribe is not a taxable entity.); and Revenue Ruling 68-231 (Bonds issued by tribal governments would not be treated similar to bonds issued by state governments.)

<sup>23</sup> The Act applies the following requirements for special manufacturing facility bonds: 95% of the bond proceeds must be used to finance property that is acquired, constructed or improved by the tribal government, the property must be of a type that is subject to depreciation and part of a manufacturing facility, the property must be on Indian lands that must be held in trust by the United States at least five years prior to the issuance of the bond and be held at all times the bonds are outstanding, and an employment test is used. See IRC §787 (C)(3).

Congress prohibited Indian tribes from issuing private activity bonds and limited tribes from issuing governmental bonds for "essential governmental functions," Congress simply failed to follow the clearly stated federal policy of tribal self-determination.

Governmental bonds<sup>24</sup> and private activity bonds<sup>25</sup> would be a vital financial tool for tribal governments because these bonds allow the government to secure capital for the building of infrastructure, which, in turn, encourages economic development within Indian reservations.

In 1984, the Treasury Department developed proposed/temporary regulations, Treasury Regulation §305.7871-1(d)(1984), T.D. 7952, 1984-1 C.B. 276), to define the term "essential governmental function." The regulations defined "essential governmental functions" as a type of function that is:

- a) Eligible for funding under the Snyder Act (25 U.S.C. §13)<sup>26</sup>;
- b) Eligible for grants or contracts under Indian Self-Determination Act (25 U.S. §450(f), (g), and (h)); or
- c) An essential governmental function under I.R.C. § 115 and the regulations thereunder when conducted by a state (or political subdivision, thereof).

The Snyder Act and the Indian Self-Determination Act are congressional acts that allow the federal government to provide funds for tribal self-governance and self-determination. When the Regulations incorporating activities that could fall under the Snyder Act and Indian Self-Determination Act, the Regulations in effect expanded the activities that tribal governments could tax-exempt finance which appear to go beyond the intent of Congress. On one hand, the regulations do not appear out of character with federal policy towards Indian tribes and the need to develop economic development. On the other hand, the Regulations did to not give much weight to the Conference Report and its examples of what is an "essential governmental function." It has been

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<sup>24</sup> Governmental bonds are obligations issued by a governmental unit (or other entity) to finance governmental operations. A local government issues these bonds for its own purposes. For example, a county can issue bonds and expect to use the proceeds to:

- build or renovate a building which the county itself will use,
- build, repair and/or maintain schools and roads,
- build and operate a county-owned power plant or sewage treatment facility.

Two distinguishing characteristics of governmental bonds are that the bond proceeds:

- will be USED by the governmental entity for its own purposes, and
- the bond-financed property will be OWNED by the governmental unit.

See IRS Module B, *Introduction to Federal Taxation of Municipal Bonds*, page B-3.

<sup>25</sup> Generally, private activity bonds are bonds issued by a governmental unit (or related entity):

- the proceeds of which will be used by an entity OTHER THAN a governmental unit, AND
- the debt service of which will be paid from private payments.

See IRS Module B, *Introduction to Federal Taxation of Municipal Bonds*, page B-4.

<sup>26</sup> The Snyder Act authorizes the Bureau of Indian Affairs to make federal expenditures to assist Indian tribes for such purposes as "industrial assistance and advancement and general administration of Indian property."

speculated that the Regulations were drafted based on comments received from tribal governments.<sup>27</sup>

After the regulations were published, seven tribal bonds were issued that totaled under \$300 million.<sup>28</sup> Six of the seven bonds were for off-reservation projects that involved "leverage buy-outs" of commercial and industrial facilities. The only bond issued for an on-reservation project was to construct a health clinic. The tribal bonds that were issued for off-reservation commercial and industrial facilities received significant negative public and media attention<sup>29</sup>. In reaction to the public scrutiny following the tribal bond offerings for off-reservation projects, Congress in 1987 amended the Indian Tribal Government Tax Status Act. The Report of the House Committee on its reason for amending the Act states:

The committee is extremely concerned about recent reports of Indian tribal governments issuing tax-exempt bonds for what are substantively interests in commercial and industrial enterprise.<sup>30</sup>

...

[W]ith respect to bonds issued by Indian tribal governments, 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. For example, issuance of bonds to finance commercial or industrial facilities (e.g. private rental housing, cement factories, or mirror facilities) which bonds technically may not be private activity bonds is not included within the scope of the essential governmental function exception.

The House Report concluded with a harsh remark of the Treasury Department regulations:

Additionally, the committee wishes to stress that only those activities that are customarily financed with governmental bonds (e.g. schools, roads, governmental buildings, etc.) are intended to be within the scope of this exception, notwithstanding that isolated instances of a State or local government issuing bonds for another activity may occur. Further, the fact that the Bureau of Indian Affairs may provide Federal assistance for Indian tribal governments to engage in commercial and industrial ventures as tribal governments activities is not intended to be determinative for purposes of the Internal Revenue Code.

<sup>27</sup> See Ellen P. Aprill, *Tribal Bonds: Indian Sovereignty and Tax Legislation Process*, 46 Admin. L. Rev. 333 (1994). See also John E. Theberge and Diana A. Imholtz, *Tax-Exempt Financing Involving Indian Tribal Governments*, The Exempt Organization Tax Review, August 2003, Vol 41, No. 2; and Kathleen M. Nilles, *Tribal Bondage: A Brief History of the Tax-Exempt Financing Rules Applicable to Tribes*, prepared for "Tribal Bonds: A Unique Case" at The Inaugural National Native American Tribal Finance Conference, February 18<sup>th</sup>-20<sup>th</sup>, 2004, The Spa Resort & Casino, Palm Springs, California.

<sup>28</sup> See Aprill, at 33.

<sup>29</sup> See Matthew Schifin, "Smoke Signals" *Forbes* (June 15, 1987) at 42.

<sup>30</sup> H.R. Rep. No. 391 at 1139.

(Any existing Treasury Department regulations that may infer a contrary result are to be treated as invalid.)<sup>31</sup>

(Emphasis added.)

Unfortunately, the amendment did little to resolve the problem, since it did not clearly define the term "essential governmental functions." Instead, the amendment added language stating that the term "essential governmental functions" shall not include any function that is not customarily performed by State and local government with general taxing powers. Congress' action in effect overturned the Regulations.

Since the 1987 amendments to the Act, there have not been any regulations defining the term "essential governmental functions." Moreover, the IRS also has not provided any guidance or instructions to tribal governments on what is or what is not an "essential governmental function."<sup>32</sup> But on November 22, 2002, the IRS issued Field Service Advice 20024712 (hereinafter "FSA") to address an issue of whether the construction and operation of the Golf Course by an Indian tribe is an "essential governmental function" within the meaning of §7871(e). The FSA examined the legislative history of the Act and the events surrounding the 1987 amendments. And the FSA also added a type of subjective balancing test in which the purpose of the activity is examined to determine whether the activity is more commercial or more governmental, in nature and purpose. This standard is very much subjective without further guidance and information. The FSA concluded, although there were 2,645 publically owned, municipal golf course in the United States, the commercial nature of the golf course owned by an Indian tribe cause it to be other than an essential function within the meaning of §7871(e).

#### IV. Proposed Resolution and How to Achieve It

The IRS should take the following steps to develop guidance and instruction to tribal governments for the term "essential governmental function":

- The IRS should request the Treasury Department to develop regulations to define "essential governmental functions" under §7871(e);
- The IRS should clarify that the "essential governmental function" under §7871(e), be construed in accordance with the term "essential governmental function" under §115.
- Withdraw FSA 200247012 and suspend issuance of any other non-precedential Guidance.

<sup>31</sup> H.R. Rep. No. 391, 100<sup>th</sup> Cong., 1<sup>st</sup> Sess. 1139 (1987).

<sup>32</sup> The Project Group examined the available material on the IRS website and publications that the IRS provides for the public.

The IRS can't develop clear guidance and advice for the term "essential governmental functions" if there are no regulations. There is hesitation by the IRS and the Treasury Department to do anything but wait for a congressional fix.

- A. The IRS should request the Treasury Department to develop regulations to define the term "essential governmental functions" under Section 7871(e).

As stated above, the Treasury Department has not developed any regulations since 1984 that defines the term "essential governmental functions." Short of Congressional legislation that fully recognizes tribal government as having equal federal tax treatment with state and local governments, a Treasury regulation defining the "essential governmental function" test under §7871(e) is the best solution. But in order to develop such regulations; the Group recommends that regulation should balance the following:

- The legislative history of the Act
- The federal policy of self-determination.

The history of the Treasury Department and IRS with the term "essential governmental functions" demonstrates a myopic vision. When Treasury Department originally developed its regulations to define "essential governmental functions," it appears that the regulations were drafted based on tribal government recommendations with little regard to the legislative history of the Act<sup>33</sup>. This decision to develop the regulation without examining the legislative history of the Act caused a Congressional backlash that resulted in the 1987 amendments to the Act. In addition, the manner by which FSA 20024712 was drafted also appears to be too one-sided.

The Group believes that the FSA relied solely upon the confusing legislative history of the Act and did not rely on any tribal policy or tribal input to develop the advice. The legislative history should not be read as imposing an additional test (i.e., "no 'commercial' activity") on the activities conducted by tribal governments. Therefore, in an attempt to provide some balance in draft subsequent regulations, the regulations should attempt to balance two sources of information – the legislative history of the Act, and the federal policy of self-determination, which is currently being implemented through the development of IRS's proposed tribal consultation policy. These regulations should be drafted with the assistance of tribal governmental representatives who are familiar with reservation communities and the unique revenue-generating opportunities found across Indian Country.

- B. The IRS should clarify that the "essential governmental function" under §7871(e), be construed in accordance with the term "essential governmental function" under §115.

Under §115, activities that make or save money for the state can be "essential governmental functions" so long as the income generated from the activity is used for a

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<sup>33</sup> See Aprill, Bonds.

governmental purpose<sup>34</sup>. The Group recommends avoiding giving inappropriate weight to the legislative history's mention of "commercial or industrial facilities" in construing §7871(e). Congress did not incorporate the phrase "commercial or industrial" facilities into the statutory language in §7871(e). Therefore, IRS guidance should focus on clarifying the words of the statute – "not customarily performed by a state or local government with taxing power," using §115.

C. Withdraw FSA 200247012 and Suspend Issuance of any other Non-precedential Guidance.

FSA 200247012 has muddied the waters. It is premised on an incorrect assumption of law – i.e., that "revenue-generating activities" conducted by a tribal government are not "essential governmental" functions. In addition to giving far too much weight to references in the committee reports to the words "industrial" and "commercial," the FSA imports a grossly subjective element into the determination of whether a particular tribal activity constitutes an essential government function. For example, the FSA suggests that "the probable role of the Golf Course in the community contrasts with that of the more typical golf course developed by a state or local government." Until the Treasury Department or IRS issues clear public guidance under §7871(e), the IRS should not be permitted to use the examination process to make new law in this area.

D. Suspend Any New Compliance Initiatives Applicable to Tribal Bonds Until After Published Guidance is Issued.

It would be inappropriate at this time for the IRS to implement any new compliance initiatives aimed at tribal bond issuances. IRS agents simply do not have adequate guidance from the IRS Chief Counsel and Treasury Department to measure compliance with the "essential governmental function" test at this time. If informal guidance is issued, it should be explicitly labeled as interim safe harbor guidance.

V. Summation

How can tribal governments develop sustainable economies that produce recurring revenues needed to provide the infrastructure for their citizens, residents and visitors, when tribal governments have their hands tied behind their back? Since the 1987 amendments, the Treasury Department hasn't published any further proposed regulations to define the term "essential governmental function." Without any guidance

<sup>34</sup> See, e.g., Revenue Ruling 90-74 1990-2 C.B. 34 (government liability pools, which met the obligations of political subdivisions to protect the financial integrity, fulfilled an essential governmental function); Revenue Ruling 77-261, 1977-2 C.B. 45 (an investment fund established by state constituted an essential governmental function). In Private Letter Ruling 200116009 (April 23, 2001), the IRS ruled that §115 excluded the income of a nonprofit corporation formed by a city to assist it in financing, acquiring, constructing and operating a convention center hotel. A key premise underlying the ruling was the IRS concluded that the operation of the hotel was an essential governmental function because it allowed the city to lessen the deficit associated with the convention center's operation.

or instruction, tribal governments and the public are left with the tedious burden of requesting separate private letter ruling to determine whether their proposed project is something that state or local governments with taxing powers "customarily" perform and whether the activity is more governmental or commercial in nature or purpose. Tribal governments and the IRS are also left to attempt to discern what Congress meant in the legislative history when it referred to "commercial or industrial facilities." Overall, the unclear definition of "essential governmental functions" leaves tribal government with the impossible task of providing governmental services to their citizens, resident, and visitors without any real ability to utilize tax-exempt, one of the biggest financial tool of nearly every state and local governments.