

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The text is overlaid on this graphic.

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*The Indian Tribal Governmental Tax Status Act: An  
Overview*

Yule Kim, American Law Division

December 20, 2007

**Abstract.** The Indian Tribal Governmental Tax Status Act (the act) was enacted in 1983 as a temporary measure and made permanent in 1985. The act extends to Indian tribal governments several favorable forms of tax treatment previously enjoyed exclusively by states and their political subdivisions. Prior to the passage of the act, the Internal Revenue Service (IRS) had concluded that, absent express statutory provisions, tribal governments were not to be treated as states for federal taxation purposes. In response to this IRS determination, Congress, recognizing that both state and tribal governments perform similar functions for their citizens, passed the act as a means of facilitating tribal governments in the exercise of their governmental powers. Two bills introduced in the 110th Congress, S. 1850 and H.R. 3164, would amend the act by giving tribal governments greater flexibility in issuing tax-exempt bonds.

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# CRS Report for Congress

## The Indian Tribal Governmental Tax Status Act: An Overview

December 20, 2007

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Prepared for Members and  
Committees of Congress

# The Indian Tribal Governmental Tax Status Act: An Overview

## Summary

The Indian Tribal Governmental Tax Status Act ( P.L. 97-473, Title II, Section 202(a) ) (the act), extends to Indian tribal governments and their subdivisions in certain specific circumstances the same tax treatment as states and their political subdivisions. For example, tribal governments may receive an exemption from certain federal excise taxes when purchasing an item if the transaction involves the exercise of an essential governmental function. Likewise, tribal governments may also issue tax-exempt bonds either to finance the exercise of an essential governmental function or to build a manufacturing facility on tribal trust lands. The act also grants deductions to individuals who make charitable donations or tax payments to tribal governments and provides various other means for tribal governments to receive favorable forms of tax treatment.

Though the act provides many forms of favorable tax treatment, these benefits are limited to the specific situations prescribed in the statute. Federal courts are unlikely to extend state tax status to tribes in other areas not explicitly authorized in the act. Furthermore, the tax treatment that tribal governments receive is severely limited by restrictions that do not apply to states. For example, exemptions from federal excise taxes and the authority to issue tax-exempt bonds are available only when a tribe is exercising an essential governmental function. This means that tribal governments cannot claim an exemption from an excise tax if the item was purchased solely for the purpose of resale to consumers. Moreover, because of the essential governmental function restriction and other restrictions embedded in the act, tribal governments do not have the same flexibility in issuing tax-exempt bonds as states.

Two bills introduced in the 110<sup>th</sup> Congress, S. 1850 and H.R. 3164, would amend the act by giving tribal governments greater flexibility in issuing tax-exempt bonds.

This report will be updated if warranted by significant legislative activity.

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# The Indian Tribal Governmental Tax Status Act: An Overview

The Indian Tribal Governmental Tax Status Act (the act) was enacted in 1983<sup>1</sup> as a temporary measure and made permanent in 1985.<sup>2</sup> The act extends to Indian tribal governments several favorable forms of tax treatment previously enjoyed exclusively by states and their political subdivisions. Prior to the passage of the act, the Internal Revenue Service (IRS) had concluded that, absent express statutory provisions, tribal governments were not to be treated as states for federal taxation purposes.<sup>3</sup> In response to this IRS determination, Congress, recognizing that both state and tribal governments perform similar functions for their citizens, passed the act as a means of facilitating tribal governments in the exercise of their governmental powers.<sup>4</sup>

## Qualified Entities Under The Act

The act applies to “Indian tribal governments” and their subdivisions.<sup>5</sup> For a tribe to qualify under the act as an “Indian tribal government,” the Treasury Department, in consultation with the Department of the Interior, must conclude that the governing body of the Indian tribe exercises “governmental functions.”<sup>6</sup> Moreover, a subdivision of an Indian tribal government will receive treatment as a

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<sup>1</sup> P.L. 97-473, Title II, § 202(a), 96 Stat. 2608 (1983) (codified as amended at I.R.C. §§ 7701(a)(4), 7871). I.R.C. refers to the Internal Revenue Code, which can be found in Title 26 of the U.S. Code.

<sup>2</sup> Deficit Reduction Act of 1984, P.L. 98-369, Div. A, Title X, § 1065(b), 98 Stat. 494, 1048 (1984).

<sup>3</sup> Rev. Rul. 58-610, 1958-2 C.B. 815 (no tribal exemption from manufacturers excise tax); Rev. Rul. 68-231, 1968-1 C.B. 48 (no exemptions for interest on bonds issued by tribes); Rev. Rul. 74-179, 1974-1 C.B. 279 (charitable bequests to tribes not allowable as a charitable deduction). I.R.S. administrative materials can be found on [<http://www.irs.gov>].

<sup>4</sup> S.Rept. 97-646, at 11 (1982). (“[I]n order to facilitate these efforts of Indian tribal governments that exercise such sovereign powers, it is appropriate to provide these governments with a status under the Internal Revenue Code similar to what is now provided for the governments of the States of the United States.”).

<sup>5</sup> I.R.C. § 7871(a).

<sup>6</sup> *Id.* § 7701(a)(40) (“The term ‘Indian tribal government’ means the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary [of the Treasury], after consultation with the Secretary of the Interior, to exercise governmental functions.”)

political subdivision of a state “if (and only if)” the Treasury Department makes a determination that the subdivision has been delegated a “substantial governmental function” by the Indian tribal government.<sup>7</sup> The statute does not define “substantial governmental function.” However, in Rev. Proc. 84-37, issued in 1984, the IRS identifies three governmental powers that it considers to be substantial governmental functions: the power to tax, the power of eminent domain, and the police power.<sup>8</sup> The IRS later applied this reasoning in a private letter ruling determining that the tribal government’s delegation of its taxation power to its subdivision, in this case a town, qualified the subdivision for tax treatment as a political subdivision of a state.<sup>9</sup>

Currently, the IRS has published lists of qualified Indian tribal governments and subdivisions, which are occasionally updated when warranted.<sup>10</sup> If a tribal government or a subdivision is not officially recognized by the Treasury Department and is not on an IRS list, the tribal government or the subdivision must, through procedures outlined by Treasury regulations, request a ruling from the IRS that it qualifies for tax treatment under the act.<sup>11</sup>

Alaska Native entities may qualify for state tax treatment under the act<sup>12</sup> and a list of Alaska Native entities is included in the IRS list of qualifying tribal governments.<sup>13</sup> The act, however, includes a provision which states: “Nothing in the Indian Tribal Governmental Tax Status Act of 1982, or in the amendments made thereby, shall validate or invalidate any claim by Alaska Natives of sovereign authority over lands or people.”<sup>14</sup> Currently, no Alaska Native Corporations are included in the IRS list.<sup>15</sup>

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<sup>7</sup> *Id.* §7871(d) (“[A] subdivision of an Indian tribal government shall be treated as a political subdivision of a State if (and only if) the Secretary of the Treasury determines (after consultation with the Secretary of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.”). *See also* Rev. Rul. 86-44, 1986-1 C.B. 376.

<sup>8</sup> Rev. Proc. 84-37, 1984-1 C.B. 513, modified, Rev. Proc. 86-17.

<sup>9</sup> I.R.S. Priv. Ltr. Rul. 200638016 (June 14, 2006).

<sup>10</sup> *See* Rev. Proc. 2002-64, 2002-2 C.B. 717 (list of Indian tribal governments); Rev. Proc. 84-36 1984-1 C.B. 510, modified, Rev. Proc. 86-17, 1986-1 C.B. 550 (list of political subdivisions).

<sup>11</sup> 26 CFR § 305.7701-1(a) (providing procedures that Indian tribal governments must follow in order to obtain tax treatment as a state); 26 CFR §305.7871-1(e) (providing procedures that subdivisions of Indian tribal governments must follow in order to obtain tax treatments as a political subdivision of a state). *See also* Rev. Proc. 84-37, 1984-1 C.B. 513.

<sup>12</sup> I.R.C. § 7701(a)(40)(B).

<sup>13</sup> *See* Rev. Proc. 2002-64, 2002-2 C.B. 717.

<sup>14</sup> I.R.C. § 7701(a)(40)(B). *See also* *Alaska v. Venetie*, 522 U.S. 520 (1998) (holding that the Indian Country statute did not apply to lands held by an Alaska Native corporation and that Alaska Native entities could not impose taxes on nonmembers conducting business on those lands).

<sup>15</sup> *See* Rev. Proc. 2002-64, 2002-2 C.B. 717.

## “Essential Governmental Function”

The act imposes a restriction on tribal governments that seek exemptions from federal excise taxes or the authority to issue tax-exempt bonds. In order for tribal governments to obtain treatment as a state in these transactions, the tribal government’s involvement in the transaction must further an “essential governmental function.”<sup>16</sup> “Essential governmental functions” are distinct from the “substantial governmental functions.”<sup>17</sup> Essential governmental functions, unlike substantial governmental functions, do not test whether an entity possesses a governmental power; rather, the test is whether the transaction in question serves or furthers a governmental purpose that the entity is supposed to fulfill for its citizens.

Section 7871(e) of the Internal Revenue Code states that “‘essential governmental function’ shall not include any function which is not customarily performed by State and local governments with general taxing power.”<sup>18</sup> Outside of this provision, there is little definitive guidance on what constitutes an essential governmental function. In a recently issued Advance Notice of Proposed Rulemaking (ANPRM), the IRS announced a rule it anticipates to propose that would define essential governmental function in the context of tax-exempt bonds as an activity (1) that numerous state and local governments have conducted and financed with tax-exempt governmental bonds (prevalence); (2) that state and local governments have conducted for many years (duration); and (3) that is not commercial or industrial.<sup>19</sup> The rule will also provide that essential governmental functions, include, but are not limited to, roads, schools, and government buildings.<sup>20</sup>

In formulating this rule, the IRS refers to both statutory language and legislative history. Establishing prevalence and duration was deemed necessary because the statutory definition of “essential governmental function” demands that activity in question be one “customarily” performed by states.<sup>21</sup> The IRS interpreted the word “customarily” to mean that the activity must be practiced by a large number of states for a long duration of time.<sup>22</sup> Moreover, the prohibition on commercial or industrial activity was included because of language in the legislative history which suggests

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<sup>16</sup> *Id.* § 7871(b), (c)(1).

<sup>17</sup> *See ante* at CRS-1.

<sup>18</sup> *Id.* § 7871(e) (“[T]he term ‘essential governmental function’ shall not include any function which is not customarily performed by State and local governments with general taxing powers.”).

<sup>19</sup> Definition of Essential Governmental Function Under Section 7871 and Limitation to Activities Customarily Performed by States and Local Governments, 71 Fed. Reg. 45474 (announced August 9, 2006).

<sup>20</sup> *Id.*

<sup>21</sup> I.R.C. § 7871(e). *See also* I.R.S. Tech. Adv. Mem. 200704019 (October 24, 2006).

<sup>22</sup> I.R.S. Tech. Adv. Mem. 200704019 (October 24, 2006).

Congress did not want tax-exempt bonds to finance commercial or industrial projects.<sup>23</sup>

The IRS has also released administrative material that provides examples of what the agency considers to be an essential governmental function. While discussing the extent of the exemptions from federal excise taxes in a Private Letter Ruling, the IRS held that school, police, and firefighting services were essential governmental functions.<sup>24</sup> In a Technical Advice Memorandum, the IRS remarked that the issuance of bonds to finance industrial or commercial facilities was not an essential governmental function while activities customarily financed with governmental bonds, such as schools, roads, and governmental buildings, did fall within the scope of the definition.<sup>25</sup>

From these sources, it appears that the IRS's current approach mirrors the method announced in the ANPRM.<sup>26</sup> The IRS now seems to classify an activity as an essential governmental function if the activity is (1) practiced by a large number of state or local governments (2) for a long duration of time and (3) is not an industrial or commercial activity.<sup>27</sup> When determining whether an activity is practiced by other state or local governments, the IRS also seems to require that the manner in which tribal governments conduct the activity must closely match the general practice of the activity among the states.<sup>28</sup>

When determining whether an activity is “commercial,” the IRS appears to approach the issue by looking at a host of factors, such as “whether the facility operates to earn a profit, competes with for-profit entities, and functions in a commercial manner.”<sup>29</sup> The IRS also looks at “the balance of the operations of the facility between service to the local community and attraction of paying customers from outside the local community.”<sup>30</sup>

There is a caveat: the ANPRM and the Technical Advice Memorandum define essential governmental function in the context of tax-exempt bonds. Even though it would seem that the IRS should use only one test to define the term since the

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<sup>23</sup> H.Rept. 100-391, at 1139 (1987) (“For example, issuance of bonds to finance commercial or industrial facilities (e.g. private rental housing, cement factories, or mirror factories)[,] which bonds technically may not be private activity bonds[,], is not included within the scope of the essential governmental function exception.”).

<sup>24</sup> Rev. Rul. 94-81, 1994-2, C.B. 412.

<sup>25</sup> I.R.S. Tech. Adv. Mem. 200704019 (October 24, 2006).

<sup>26</sup> *See id.*

<sup>27</sup> *See id.*

<sup>28</sup> *Id.* (E.g., “it is not enough that a lodge owned and operated by an Indian tribal government accept paying guests for overnight stays in private rooms like a state owned lodge; instead the lodge must be comparable in other dimensions as well, such as size and amenities.”).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*



provision defining essential governmental function covers the entirety of the act,<sup>31</sup> there is no guarantee that the IRS will.

## Ways In Which Tribal Governments Are Treated As States

**Exemptions From Federal Excise Taxes.** The act offers Indian tribal governments exemptions from a select number of federal excise taxes similar to exemptions enjoyed by states.<sup>32</sup> The tax treatment includes exemptions from:

- taxes imposed on the sale or use of certain liquid fuels if used exclusively by the tribal government or its subdivisions;<sup>33</sup>
- various manufacturers excise taxes if the article sold to a tribal government or its subdivisions will be used exclusively by the tribal government or its subdivisions;<sup>34</sup>
- communication taxes if the communication services or facilities are furnished for the use of a tribal government or its subdivisions;<sup>35</sup> and
- the highway use tax for any use of a highway motor vehicle used by a tribal government or its subdivisions.<sup>36</sup>

Exemptions from federal excise taxes are limited to transactions that involve “the exercise of an essential governmental function of the Indian tribal government.”<sup>37</sup> Purchases made in furtherance of an essential governmental function will qualify for an exemption if there is a provision in the act covering the transaction.<sup>38</sup> On the other hand, even if a statutory provision in the act expressly grants an exemption for the purchase of an item, if the item was purchased for the purpose of resale to consumers, the purchase does not serve an essential governmental function.<sup>39</sup> Therefore, purchases made by tribal governments for the purpose of resale are not exempt from federal excise taxes.<sup>40</sup>

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<sup>31</sup> See I.R.C. § 7871(e).

<sup>32</sup> I.R.C. § 7871(a)(2)

<sup>33</sup> *Id.* § 4041(g)(2). See also *id.* § 4041(a)(1), (2).

<sup>34</sup> See generally *id.* ch. 32.

<sup>35</sup> See *id.* § 4253(i).

<sup>36</sup> See *id.* § 4483(a).

<sup>37</sup> *Id.* § 7871(b).

<sup>38</sup> Rev. Rul. 94-81, 1994-2, C.B. 412.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

Indian tribes do not have “inherent exemption” from federal excise taxes.<sup>41</sup> State exemptions available to Indian tribal governments are limited to those expressly provided for in the act.<sup>42</sup> For example, although states are exempt from federal wagering and occupational taxes,<sup>43</sup> the act does not expressly extend this exemption to tribes. In *Chickasaw Nation v. United States*, the Supreme Court held that the Indian Gaming Regulatory Act did not exempt tribes from paying the tax on lottery styled pull-tab games even though there were provisions providing that tribes were to be treated like states for matters concerning the reporting and withholding of such taxes.<sup>44</sup> Though this case was based on statutory construction, it demonstrates the reluctance of the federal courts to infer exemptions from federal excise taxes for Indian tribes in the absence of express provisions.

**Tax-Exempt Tribal Bonds.** The act also provides tribal governments, in a manner similar to states, the authority to issue tax-exempt bonds.<sup>45</sup> Tax-exempt bonds facilitate capital formation for tribal governments by excluding the interest earned on these bonds from gross income of bondholders for federal income taxation purposes.<sup>46</sup> This results in lower cost of capital for tribal governments since tribal bonds can offer lower yields than private bonds while still ensuring high-income investors a competitive after-tax return.<sup>47</sup> Tribal governments, however, do not have the same flexibility in financing projects with tax-exempt bonds that states enjoy. Congress has instead restricted the ways in which tribal governments can use the proceeds from tax-exempt bonds: tribal governments can either use “governmental bonds” to finance a project which furthers an essential governmental function<sup>48</sup> or use “private activity bonds” to finance the construction of a manufacturing facility if certain specific criteria are met.<sup>49</sup>

**Governmental Bonds.** Governmental bonds are generally used to finance public infrastructure.<sup>50</sup> As mentioned above, in the context of tribal bonds, in order to issue a governmental bond, substantially all of the proceeds of the bond must finance a project that is an exercise of an essential governmental function, i.e., a function customarily exercised by a state or local government with general taxing

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<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> I.R.C. § 4402(3). *See generally* I.R.C. ch. 35 (taxes on wagering).

<sup>44</sup> 534 U.S. 84 (2001).

<sup>45</sup> I.R.C. § 7871(a)(4). *See also* I.R.C. § 103.

<sup>46</sup> *See* CRS Report RL30638, *Tax-Exempt Bonds: A Description of State and Local Government Debt*, by Steven Maguire.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* § 7871(c)(1).

<sup>49</sup> *Id.* § 7871(c)(3).

<sup>50</sup> *See* CRS Report RL34159, *Private Activity Bonds: An Analysis of State Use, 2001 to 2005* by Steven Maguire and Heather Durkin Negley.

powers.<sup>51</sup> When determining whether an activity being financed by the issuance is an essential governmental function, the IRS appears to use a test that evaluates (1) whether many state or local governments practice the activity, (2) whether state or local governments have practiced the activity for a long period of time, and (3) whether the activity is industrial or commercial.<sup>52</sup> Furthermore, in order for a tax-exempt bond to be issued for an essential governmental function, “substantially all”<sup>53</sup> (i.e., 90% or more) of the proceeds of the bond must go to the essential governmental function.<sup>54</sup>

**Private Activity Bonds.** Private activity bonds<sup>55</sup> are bonds issued by governmental entities, the proceeds of which go to private business use.<sup>56</sup> Section 141 of the Internal Revenue Code provides the statutory definition of private activity bond: a private activity bond is a bond that satisfies both the private business use test<sup>57</sup> and the private security or payment test.<sup>58</sup> Section 141 also states that a bond is a private activity bond if it satisfies the private loan financing test.<sup>59</sup> Private activity bonds are not tax-exempt.

States and their political subdivisions, however, can authorize the issuance of tax-exempt “qualified private activity” bonds for certain specific purposes.<sup>60</sup>

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<sup>51</sup> *Id.* § 7871(e).

<sup>52</sup> See I.R.S. Tech. Adv. Mem. 200704019 (October 24, 2006).

<sup>53</sup> See 26 C.F.R. § 1.103-8(a) (“Substantially all of the proceeds of an issue of governmental obligations are used to provide for an exempt facility if 90 percent or more of such proceeds are so used.”). It should be noted that the definition in 26 C.F.R. § 1.103-8(a) was referenced by 26 C.F.R. § 305.7871-1(c), a temporary regulation that is no longer effective. However, the terms mirror each other in similar statutory provisions, so it stands to reason the definition of “substantially all” in I.R.C. § 7871 mirrors that of I.R.C. § 103.

<sup>54</sup> I.R.C. § 7871(c)(1).

<sup>55</sup> See CRS Report RL34159, *Private Activity Bonds: An Analysis of State Use, 2001 to 2005* by Steven Maguire.

<sup>56</sup> I.R.C. § 141(b)(6) (“[T]he term ‘private business use’ means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. [U]se as a member of the general public shall not be taken into account.”).

<sup>57</sup> *Id.* § 141(b)(1). The private business use test is satisfied if more than 10 percent of the proceeds of the issue are to be used for any private business use.

<sup>58</sup> *Id.* § 141(b)(2). The private security or payment test is satisfied if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is either directly or indirectly (1) secured by an interest in either property used or to be used for a private business use or payments in respect of such property, or (2) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

<sup>59</sup> *Id.* § 141(c). The private loan financing test is satisfied if the amount of the proceeds of the issue which are to be used to make or finance loans to persons other than governmental units exceeds the lesser of 5 percent of such proceeds or \$5,000,000.

<sup>60</sup> See *id.* § 142 (qualified public activity bonds issued to finance certain facilities), § 143 (continued...)

Qualified private activity bonds finance a variety of projects with a private business use, such as the construction of qualified residential rental projects.<sup>61</sup>

With one exception, tribal governments are prohibited by the act from issuing all tax-exempt private activity bonds, including qualified bonds.<sup>62</sup> Tribal governments can issue tax-exempt private activity bonds to finance the construction of certain manufacturing facilities on Indian tribal lands held in trust by the United States.<sup>63</sup> In order for a private activity bond to qualify for this exception:

- 95 percent or more of the net proceeds of the issue are to be used for the acquisition, construction, reconstruction, or improvement of property which is of a character subject to the allowance of depreciation and which is part of a manufacturing facility;<sup>64</sup>
- the bond must be issued by an Indian tribal government or a subdivision thereof;<sup>65</sup>
- 95 percent or more of the net proceeds of the issue are to be used to finance property which (1) is to be located on land which, throughout the five-year period ending on the date of issuance of such issue, is held in trust by the United States for the benefit of the issuer tribe and (2) is to be owned and operated by such issuer tribe;<sup>66</sup>
- such bond would not, outside of its purpose to finance the manufacturing facility, be a private activity bond;<sup>67</sup>

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<sup>60</sup> (...continued)

(qualified public activity bonds issued to finance owner-occupied residences), § 144 (qualified small issue bonds, qualified student bonds, and qualified redevelopment bonds), § 145 (bonds issued for qualified 501(c)(3) organizations). *See also* CRS Report RL31457, *Private Activity Bonds: An Introduction*, by Steven Maguire.

<sup>61</sup> *Id.* § 103(b). *See also id.* §§ 142-145.

<sup>62</sup> *Id.* § 7871(c)(2).

<sup>63</sup> *Id.* § 7871(c)(3)(B).

<sup>64</sup> *Id.* § 7871(c)(3)(B)(i). *See also id.* § 144(a)(12)(C) (“[T]he term ‘manufacturing facility’ means any facility which is used in the manufacturing or production of tangible personal property.”).

<sup>65</sup> *Id.* § 7871(c)(3)(B)(ii).

<sup>66</sup> *Id.* § 7871(c)(3)(B)(iii).

<sup>67</sup> *Id.* § 7871(c)(3)(B)(iv).

- it is reasonably expected (at the time of issuance) that an employment requirement<sup>68</sup> be met with respect to the facility to be financed by the net proceeds of the issue;<sup>69</sup> and
- no principal user of such facility will be a person who (1) guarantees, arranges, participates, or assists with the issuance of any bond the proceeds of which are to be used to finance the facility or (2) provides any property, or any franchise, trademark, or trade name which is to be used in connection with the facility.<sup>70</sup>

**Tribal Tax Deductions.** Payments for tribal taxes enumerated in Section 164 of the Internal Revenue code are deductible from federal income taxes in the same manner as state taxes.<sup>71</sup> Taxes imposed by subdivisions of Indian tribal governments are treated as “local taxes” and are also deductible.<sup>72</sup> The types of taxes that are deductible are:

- real property taxes;<sup>73</sup>
- personal property taxes;<sup>74</sup>
- income, war profits, and excess profits taxes;<sup>75</sup>
- “Generation-Skipping Transfer”<sup>76</sup> taxes;<sup>77</sup> and
- taxes which are paid or accrued within the taxable year in carrying on a trade or business or activity relating to expenses for the production of income.<sup>78</sup>

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<sup>68</sup> *See id.* § 7871(c)(3)(D) (generally requiring that, at the end of a calendar year during a specified “testing period,” the aggregate face amount of all outstanding tax-exempt private activity bonds issued to provide financing for the facility is not more than 20 times greater than the aggregate wages paid, in the preceding calendar year, to members of the issuer tribe or their spouses who rendered services to the facility).

<sup>69</sup> *Id.* § 7871(c)(3)(B)(v).

<sup>70</sup> *Id.* § 7871(c)(3)(B)(vi); *id.* § 144(a)(6)(B).

<sup>71</sup> *Id.* § 7871(a)(3).

<sup>72</sup> S. Rep. No. 97-646, at 15.

<sup>73</sup> *See* I.R.C. § 164(a)(1).

<sup>74</sup> *Id.* § 164(a)(2).

<sup>75</sup> *Id.* § 164(a)(3).

<sup>76</sup> “A conveyance of assets to a person more than one generation removed from the transferor...” Black’s Legal Dictionary 694 (7<sup>th</sup> ed. 1999).

<sup>77</sup> I.R.C. § 164(a)(4).

<sup>78</sup> *Id.* § 164(a). *See also id.* § 212 (describing what constitutes expenses related to the production of income).

**Charitable Deductions.** Charitable donations made to Indian tribal governments are deductible from federal income, estate, and gift taxes.<sup>79</sup> These gifts, however, must be made for “exclusively public purposes,” with this restriction being applied in a manner comparable to its application to state governments.<sup>80</sup>

**Other Provisions of the Act.** There are a number of additional ways in which the act treats tribes like states. The act:

- authorizes the application of the unrelated business income tax to tribal colleges;<sup>81</sup>
- permits the amount of discount at which certain tribally issued short-term debts are originally sold to be considered to accrue only when the debt is paid at maturity, sold, or otherwise disposed of;<sup>82</sup>
- permits tribal employees to exclude from their gross income tribal contributions to certain annuity plans for federal income tax purposes;<sup>83</sup>
- subjects expenditures to attempt to influence the legislation of tribal governments to the tax on excessive lobbying expenditures;<sup>84</sup>
- permits tribes to be treated like states for purposes of the various taxes imposed on private foundations;<sup>85</sup> and
- permits amounts received from a sickness and disability fund for employees maintained under the law of a tribe to be treated as amounts received as accident or health insurance, and thus excludible from the gross income of the employee so long as the amount constitutes reimbursement for medical care or payment for permanent injury.<sup>86</sup>

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<sup>79</sup> *Id.* § 7871(a)(1)(A), (B), (C).

<sup>80</sup> S. Rep. No. 97-646, at 15.

<sup>81</sup> *Id.* § 7871(a)(5). *See also id.* § 511(a)(2)(B).

<sup>82</sup> *Id.* § 7871(a)(6)(C). *See also id.* § 454(b)(2).

<sup>83</sup> *Id.* § 7871(a)(6)(B). *See also id.* § 403(b)(1)(A)(ii).

<sup>84</sup> *Id.* § 7871(a)(7)(A). *See also id.* ch. 41

<sup>85</sup> *Id.* § 7871(a)(7)(B). *See also id.* ch. 42.

<sup>86</sup> *Id.* § 7871(a)(6)(A). *See also id.* § 105(e)(2).

## Pending Legislation

**S. 1850 and H.R. 3164.** Currently, there are two bills, S. 1850 and H.R. 3164,<sup>87</sup> which, if enacted, would:

- Expand the tax-exempt bonding authority of tribal governments by amending Section 7871(c) of the Internal Revenue Code. The tax-exempt bonding authority provided for under Section 103 of the Internal Revenue Code would apply only if (1) “95% or more of the net proceeds” of the tribal bond issuance “are to be used to finance any facility [other than any portion of a building housing or used for Class II or Class III Indian gaming<sup>88</sup>] located on the Indian reservation”<sup>89</sup> of the tribal government or (2) substantially all of the proceeds of the bonds are to be used in the exercise of an essential governmental function.<sup>90</sup> This bill effectively allows tribal governments to issue the same “qualified private activity bonds” that states are currently allowed to issue. It may also be the case that the tribal authority to issue tax-exempt private activity bonds could be even broader than the states’ because the bill allows tribal governments to issue tax-exempt bonds to finance “any facility” located within “Indian reservations.”<sup>91</sup> “Any facility” could mean facilities used for private business use which may not be covered under a qualified private activity bond. Because of the broad definition of “Indian reservation”<sup>92</sup> and the reference to “any facility,” tribal governments may have broader leeway to issue private activity bonds than states.
- Alter the definition of essential governmental function by amending Section 7871(e) of the Internal Revenue Code. “Essential governmental function” will be defined to include “any function which is performed by a State or local government with general

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<sup>87</sup> S. 1850, 110<sup>th</sup> Cong. (2007); H.R. 3164, 110<sup>th</sup> Cong. (2007).

<sup>88</sup> See 25 U.S.C. § 2702 (provision of the Indian Gaming Regulatory Act defining Class II and Class III gaming).

<sup>89</sup> S. 1850 and H.R. 3164 define “Indian reservation” by reference to 25 U.S.C. § 1903(10), which, in turn, refers to the Indian country statute, 18 U.S.C. § 1151. Thus, “Indian reservation” includes “all land within the limits of any Indian reservation under the jurisdiction of the United States Government, notwithstanding the issuance of any patent..., all dependent Indian communities within the borders of the United States..., and all Indian allotments.” “Indian reservation” also includes “any lands, not covered under 18 U.S.C. § 1151, which are either “held in trust by the United States for the benefit of any Indian tribe or individual” or “held by any Indian tribe or member subject to a restriction by the United States against alienation.”

<sup>90</sup> S. 1850, 110<sup>th</sup> Cong. § 2 (2007); H.R. 3164, 110<sup>th</sup> Cong. § 2 (2007).

<sup>91</sup> *Id.*

<sup>92</sup> The definition of “Indian reservation” includes fee lands located within Indian reservations and trust lands located outside of Indian reservations.

taxing powers.”<sup>93</sup> Tribal governments would no longer need to show that the function is “customarily” performed by such state or local government. Under this change, it would seem that tribal governments would no longer have to establish that an activity was practiced by a large number of states for a long period of time in order to establish that it was an essential governmental function.

- Exempt any security, including tax-exempt bonds, issued by a tribal government from the federal registration requirements imposed upon initial offerings of securities by amending Section 3(a)(2) of the Securities Act of 1933.<sup>94</sup> States and their political subdivisions currently enjoy this exemption from the federal registration requirements.<sup>95</sup>

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<sup>93</sup> S. 1850, 110<sup>th</sup> Cong. § 3 (2007); H.R. 3164, 110<sup>th</sup> Cong. § 3 (2007).

<sup>94</sup> S. 1850, 110<sup>th</sup> Cong. § 4 (2007); H.R. 3164, 110<sup>th</sup> Cong. § 4 (2007).

<sup>95</sup> 15 U.S.C. § 77c(a)(2).