United States Senate Committee on Finance

Hearing on

"Indian Governments and the Tax Code: Maximizing Tax Incentives for Economic Development"

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The National Congress of American Indians (NCAI) is the intergovernmental body for American Indian and Alaska Native tribal governments. For over sixty-years tribal governments have come together as a representative congress through NCAI to deliberate issues of critical importance to tribal governments and endorse consensus policy positions. NCAI is honored to present at the Senate Finance hearing to discuss American Indian finance issues that our membership has deemed critical to growing tribal economies, and more importantly, critical for tribal leadership to effectively govern and serve their tribal populations.

There are a few high-profile examples of tribes around the country who have prospered economically. However, there are hundreds more who remain nearly invisible, who are struggling to preserve their reservations, their culture, and their sovereignty. Most reservations are characterized by extensive land bases, spread out communities, and homesteads mired in one long-standing poverty cycle. Most Indian tribes experience economic and social conditions that are on par with many developing nations.

While relatively few tribes have prospered, there is a perception by the American pubic and some in Congress that gaming has created wealth in tribes all across the country with a few tribes excepted. This perception could not be farther from reality.

Real per-capita income of Indians living on reservations is still less than half of the national average. Unemployment is still double what it is for the rest of the country. A full 8 of the 10 poorest counties in the United States are home to Indian reservations. Many tribal governments lack the ability to provide the basic infrastructure most U.S. citizens take for granted, such as passable roadways, affordable housing, plumbing, electricity and telephone service. It is difficult to believe that in America, where 97.5% of households have a phone, there are reservations are unable to provide basic telephone service to 70% of their citizens. In addition, there is a tribal average of 3 in 10 households without basic means of communication.

These substandard economic and quality of life indicators have a social toll as well. Health disparities are prevalent and suicide rates (a symptom of lack of opportunity) are high with over 60% more incidents than the average in America. Alcoholism on reservations and diseases like Tuberculosis are both over 500% higher among Indians.

Despite the challenging social and economic conditions on reservations, there are a number of recent economic successes resulting from tribes exercising their sovereignty and utilizing available federal tools to grow their local economies and provide their citizens with a better quality of life – the goal of every government. For example, a few tribes located near major metropolitan centers have seen startling success by creating destination gaming enterprises. Some tribes further from population centers operate gaming venues that serve to create reservation jobs and provide limited government program support.

Tribes and Alaska Native Corporations have become viable federal business partners by providing products and services to the federal government, the largest purchaser of goods and services. Government contracting has the added benefit of giving members diverse career choices and not just a job at home.

Tribes are beginning to witness energy success stories from a couple of tribes that have managed to produce and develop their natural resources. Instead of having lease agreements for outside companies to develop tribal natural resources, tribes are looking to partner to develop their own resources to create an economic base and employment opportunities.

Even with these successes, the need for economic development in Indian Country remains acute and impacts nearly every aspect of reservation life and tribal governance. Tribal leaders are confronted with many of the same challenges that other government leaders face in this country. However, tribal governments lack an adequate tax base to provide basic citizen services.

Tribes cannot impose property taxes on trust land. Sales taxes are regressive and require a viable underlying economy and an income tax on impoverished people will not create a sustainable government revenue base. Recent Supreme Court cases have compounded this problem by permitting state taxation on Indian land while at the same time limiting the ability of tribes to tax non-Indians.

Tribal leaders have greater needs than their non-Indian counterparts and, at the same time, tribal governments have fewer resources with which to fulfill their governmental responsibilities to their citizens. Meaningful economic development is sorely needed because it has been proven to be a successful means for tribes to create the sustainable revenue base considered necessary for any government to function.

The researchers at the Harvard Project on American Indian Economic Development and others have found time and time again, that creating an environment which supports tribal self-determination and tribally-driven economic development is the most effective strategy for confronting the persistent poverty in many Indian communities. This same conclusion was drawn in a report prepared for the Department of Health and Human Services in 2004.[1] The report concluded that of the more than 100 federal programs available to assist tribes or tribal members with economic development,[2] none stands out as the most beneficial for every tribe. Rather, the researchers concluded, "the federal government's ongoing commitment to Indian self-determination, tribal self-governance, and tribal sovereignty has had a positive impact on [business and economic development] in Indian country."[3] In acknowledging this reality, it is vitally important that federal policy makers give tribal governments the tools necessary to create vibrant economies on reservations that empower tribal leaders to govern effectively.

Capital - Financing a Revenue Base

Developing an economic base to fund government programs in lieu of a tax base requires capital. Congress has already recognized that Indian tribal governments need policies that ensure fair access to the same public financing tools available to other governments when raising capital when it enacted 26 USC 7871. Congress has also recognized the need to provide incentives for external capital to invest in building a tribal economic base through the use of business tax credits by including the incentives in the Omnibus Budget and Reconciliation Act of 1993.

Both of these capital needs were well-intended and aligned with the federal policy of tribal self determination. However, subsequent congressional actions and regulations caused these promising tools to be dramatically underutilized for their intended purposes and fall short of their initial goals.

Congress currently has a tremendous opportunity to fulfill the original intent of providing cost-effective financing and directing external capital to Indian tribes. However, it is appropriate to look back on previous federal policy efforts and the consequences that are related to today's discussion.

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[1] Hillabrant, et al., "Overcoming Challenges to Business and Economic Development in Indian Country," (August 2004).

[2] A 2001 GAO report estimated that there are approximately 100 federal programs to assist Indian tribes and tribal members with economic development. This is in addition to any regulatory advantages and tax incentives intended to promote economic development on tribal lands. Government Accountability Office, "Economic Development: Federal Assistance Programs for American Indians and Alaska Natives," (December, 2001) (GAO-02-193).

[3] Hillabrant, et al., "Overcoming Challenges to Business and Economic Development in Indian Country," (August 2004).

Economic conditions in Indian Country were dismal at the turn of the 20th century. In 1887, Congress adopted the General Allotment Act, which broke up much of the tribal land base in an attempt to move Indians into the agricultural economy by promoting farming. Within 50 years, non-Indians had acquired 90 million acres of tribal land, reducing Indian landholdings from 140 million acres to 50 million acres.

The Allotment Act was intended to promote farming by Indians. But the tribes had no means to obtain irrigation water, a necessity for agriculture – especially in the undeveloped arid west. The 1902 Reclamation Act extended billions of dollars of irrigation subsidies to non-Indian farmers. Yet despite its trust responsibility, the federal government left Indians out of the reclamation program, denying the tribes a prime opportunity to improve their economies. The National Water Commission called it "one of the sorrier chapters…in the history of the United States Government's treatment of Indian tribes."[4]

In today's sophisticated global economy, access to capital is as important as access to water in an agricultural economy. Giving Indians a plot of land and expecting success while other farmers could more easily take advantage of subsidized irrigation is unrealistic. And given the importance of capital for economic growth, it is important that finance tools are applied equitably and given a fair chance at succeeding in their intended purpose.

Congress recently passed the Economic Stimulus Act of 2008, which provided direct incentives to individuals in order to boost consumer spending along with businesses tax credits intended to boost capital expenditures. While the bill was still being considered, the National Congress of American Indians proposed an American Indian Stimulus Package to accompany the measure. The American Indian Stimulus Package focused on three primary considerations that would directly affect the American Indian economy: 1.) clarification of the "essential government function" definition in order to promote tribal use of tax exempt bond financing, which is consistent with creating an economic revenue base and would create infrastructure projects and jobs on the reservation; 2.) authorization of a long-term extension of the business tax incentives, including the use of accelerated depreciation and Indian employment tax credits in order to promote external economic partners; and 3.) clarification of the federal tax code so as to allow tribes to transfer energy production tax credits that would stimulate investment in tribal energy resources.

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[4] Based on Building Reservation Economies and Sustainable Homelands, A Proposal for a Progressive Tribal-Federal Effort. Tribal Leaders Economic Summit, Washington DC, January 1993

The American Indian Stimulus Package focuses on providing a fix to existing legislation. All the components are proven to be effective, but tribes have not been given the opportunity to access their full use. For example, Congress and subsequent IRS actions have limited the use of tax exempt bonds by applying a strict definition to "essential government function" prior to a tribe issuing tax exempt debt.

Access to Existing Government Financing Tools

Congress first authorized tribes to issue tax-exempt bonds in 1982. At that time, it limited tribes to issuing tax-exempt bonds for "essential governmental purposes," but did not define the term. In 1984, the Treasury Department issued Regulations that defined an essential governmental function very broadly for tribal purposes. Among other things, this included matters treated as essential governmental purposes for states and local governments under Section 115 of the Internal Revenue Code, in addition to the many commercial and industrial activities eligible for funding under the Snyder Act and the Indian Self-Determination Act.

In 1987, Congress modified the broad regulatory definition of an essential governmental function by amending the law so that it did "not include any function which is not customarily performed by State and local governments with general taxing powers." The 1987 amendment does not affirmatively define an essential governmental function, but simply excludes certain types of facilities from the eligibility list.

Congress' intent was simply to limit tribes to the same essential governmental functions that apply to state and local governments. However, conflicting views as to what Congress intended are paralyzing the ability of tribes to access the low-cost benefits of tax-exempt financing—the very benefit that was intended for tribes by the 1982 Act.

In 2004, the Advisory Committee on Tax Exempt and Government Entities concluded their report with a question and comments that more than justify congressional action:

> "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 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."
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> **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 [financing], one of the biggest financial tools of nearly every state and local governments.**[5]

The strict interpretation of tribal tax-exempt uses has also led to greater IRS audits. According to a white paper written by Professor Gavin Clarkson[6] for the NCAI Policy Research Center (attached), fewer than 1% of the tax-exempt municipal offerings are audited by the IRS each year. Yet direct tribal tax-exempt issuances are thirty times more likely to be audited within four years of issue. Needless to say, the additional cost of private letter filings, increased risk of IRS audits and the lack of allowable financing clarity has had a stifling effect on the tribal tax exempt market with fewer than 5 tribal issues on average being placed per year.

Even tribes that have sought financing projects that would appear by any other measure to be essential have been denied mostly because there is a commercial component that would also utilize the service. For example a tribe attempted to secure financing for a water distribution system and reservoir only to be disallowed because it would serve the tribe's commercial enterprise. The same held true for a tribe trying to establish a parking garage. Other state and local governments typically provide roads, water, parking to attract businesses with no challenges to their bond offerings. State and local governments routinely finance golf courses, marinas and convention centers. Even the new Yankee stadium is being built with the proposed use tax exempt financing although some are finally questioning the public benefit.[7]

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[5] Advisory Committee on Tax Exempt and Government Entities
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[6] Capital and Finance Issues: Tribal Enterprises, Authored by Dr. Gavin Clarkson

[7] News Day, Tax-exempt aid for new Yankee Stadium raises questions, by Keith Herbert and Michael Frazier

The current law, with its focus on the essential governmental function test, tends to hamstring any intergovernmental efforts, as well as public-private partnerships. For example, currently there is a tribe that is interested in using tax-exempt financing for a modest community health clinic. The clinic project is being undertaken jointly with a local municipality. Since the tribe's population is not large enough to support an Indian-only facility, the new clinic would serve both tribal members and county residents on a fee-for-service basis. There is significant concern that the IRS could view this as a commercial enterprise because it is not limiting its provision of services to the tribal community.

Uncertainty and risk are two formidable roadblocks to raising capital. Congress should act to provide clear guidance on the use of tax exempt financing so tribes can utilize one of the most effective government financing tools to meet basic citizen infrastructure needs and develop a revenue stream for government programs.

Business Tax Incentives – External Capital

The second part of the American Indian Stimulus Act deals with providing tribes with the ability to attract external capital onto reservations through the use of business incentives. The incentives were initially enacted in 1993 for a ten-year period in response to the poor state of the American Indian economy. They consist of accelerated depreciation for businesses locating on reservations and an additional wage and health care tax credits. The business investment tax credits have proven to be some of the most successful incentives for tribes to attract non-Indian investment onto Indian lands to address underdeveloped infrastructure and high reservation unemployment rates.

Since their initial implementation in 2003, they have been renewed on a short term basis with the latest one-year extension expiring in December of 2008. The short term extensions send a mixed message to businesses especially those that could make the biggest difference in elevating an Indian economy - large natural resource development firms that take years to develop and even longer to build manufacturing and capital facilities needed to function. Having an incentive renewed periodically by Congress presents added risk and uncertainty to potential partners.

This incentive is more timely now than in the past because there have been important economic factors that make these incentives more compelling for tribes. Political and consumer sentiment has shifted toward domestic and alternative energy production and, more important from a business perspective, cost-effective price points have been reached in the energy sector making large scale domestic production of coal and oil profitable and alternative energy development more attractive. With the help of Congress, tribes developing and producing energy are on the verge of transforming their economies by partnering to develop their natural resources. Congress should send a clear message to businesses looking to partner with tribes in growing their local economy and providing needed employment to their citizens. The incentives should be extended on a long-term basis.

The final component to the American Indian Stimulus Package directly deals with tribes developing energy resources as an equal partner. Tribes with large land bases, often among the most in need of development, are seeing a renewed interest in the development of their natural resources. Tribes are currently competing at a disadvantage to businesses when trying to attract energy development projects. Tribes are not eligible to use the investment incentives set aside for businesses effectively making energy investments by tribes more costly and placing them at a competitive disadvantage. To stimulate investment in energy, tribes should have the same ability to use tax incentives as other businesses when developing their natural resources.

Congress should ensure that tribes have the ability to compete in developing their existing resources and creating renewable energy by amending the existing codes to authorize tribes to sell the available tax credits. This would place tribes in the position of partnering to increase both existing domestic energy production and renewable energy projects.

Conclusion

When a bank underwrites a loan to a business, it ensures the business plan calls for enough capital to succeed. There is no business case for lending half the money in the hopes the bank will only limit its losses to half the amount requested. A bank ensures the business has enough capital so that it can earn interest on the loan and become a long term customer.

Congress has given tribal governments the tools to access and attract capital but has not authorized their full use. Because of built-in uncertainty, added cost and risks, tribes have not been given the full opportunity to succeed. To be successful, Congress should give tribes full use of government financing authority and business incentives to build an underlying economy and government revenue stream.

Currently Congress is discussing the merits of a second stimulus package based on infrastructure spending. Creating a federally subsidized infrastructure program without giving the tribes the same tools as other governments will only deepen the economic divide. Tribes deserve the opportunity to use the finance tools, create a vibrant and healthy economy, and reduce their dependence on federal programs.

Attachments

National Congress of American Indians Policy Research Center White Paper entitled Capital and Finance Issues: Tribal Enterprises by Professor Gavin Clarkson

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Reference Resources

- Testimony of Scott Schickli before the Subcommittee on Long-Term Growth and Debt Reduction, Committee on Finance, United States Senate, May 23, 2006.
- Paul Moorehead, Draft Papers on Economic Development Tax Incentives.
- Gavin Clarkson, National Congress of American Indian Policy Research Center, Capital and Finance Issues: Tribal Enterprises. Gavin Clarkson before the Subcommittee on Long-Term Growth and Debt Reduction, Committee on Finance, United States Senate, May 23, 2006.
