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Written Testimony of President Fawn Sharp National Congress of American Indians March 4, 2020

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On behalf of the National Congress of American Indians (NCAI), thank you for holding this hearing on “Examining the Impact of the Tax Code on Native American Tribes.” I am Fawn Sharp, President of the Quinalt Indian Nation and President of NCAI. I look forward to working with members of this Subcommittee and other members of Congress to address governmental disparities and economic development barriers impacting tribal nations under the Internal Revenue Code (Tax Code).

Founded in 1944, NCAI is the oldest and largest representative organization serving the broad interests of tribal nations and communities. Tribal leaders created NCAI in response to federal policies that threatened the existence of tribal nations. Since then, NCAI has fought to preserve the treaty and sovereign rights of tribal nations, advance the government-to-government relationship, and remove structural impediments to tribal self-determination.

Congress has trust and treaty responsibilities to ensure federal tax policy affords tribal nations the same opportunities as other governments to provide for their citizens. In 2017, Indian Country was left out of the Tax Cuts and Jobs Act which constituted the most significant change in federal tax policy in over 30 years. This exclusion was unacceptable because Indian Country has critical economic development needs, and our nations have been advocating for governmental parity and increased access to capital for decades.

In light of this failure by the federal government to uphold its responsibilities to tribal nations and their citizens, NCAI formed its Task Force on Tax and Finance. The purpose of the Task Force is to convene tribal leaders and experts on federal tax policy issues, develop solutions that will eliminate barriers to tribal economic development, and educate NCAI’s membership on tribal tax and finance issues as it considers policy priorities through NCAI’s resolutions process.

This testimony addresses longstanding tribal tax policy priorities and reflects the ongoing advocacy of tribal nations to ensure the federal government upholds its responsibilities to Indian Country through federal tax policy.

Political Relationship Between Tribal Nations and the United States

There are 574 federally recognized tribal nations within the United States that are rich in their geographic, political, and cultural diversity. These nations span Alaska Native villages in the Arctic to the Havasupai Tribe at the floor of the Grand Canyon to the

Wampanoag nations in Massachusetts, whose ancestors provided the food and shelter that sustained the Pilgrims prior to the formation of the United States.

Tribal nations are members of the original family of American governments and have a unique legal and political relationship with the United States as defined by the U.S. Constitution, treaties, statutes, court decisions, and executive orders.

This body of law establishes three key principles.¹ First, Congress has plenary authority over matters involving Indian Affairs and state law ordinarily does not apply within Indian Country absent authorization by Congress. Second, tribal nations retain inherent sovereign authority over their lands and resources as sovereign nations within the United States. Lastly, through its acquisition of land and resources, the United States formed a fiduciary relationship with tribal nations whereby it has recognized a trust relationship to safeguard tribal rights, lands, and resources.² In fulfillment of this tribal trust relationship, the United States “charged itself with moral obligations of the highest responsibility and trust” toward tribal nations.³

The federal government’s adherence to its fiduciary obligations – or lack thereof – has been shaped by various eras of Indian policy. For instance, past federal policies included tribal political termination and forced assimilation of American Indian and Alaska Native people. However, these policies have been repudiated and for the past fifty years the United States has formally committed to supporting tribal self-determination and self-governance, as embodied in the following passage:

The Congress declares its commitment to the maintenance of the Federal Government’s unique and continuing relationship with, and responsibility to, individual Indian tribes and to the Indian people as a whole...In accordance with this policy, the United States is committed to supporting and assisting Indian tribes in the development of strong and stable tribal governments, capable of administering quality programs and ***developing the economies of their respective communities.***⁴

As an exercise of its federal trust responsibility, Congress continues to enact legislation that supports tribal self-governance and self-determination.⁵

¹ See *Johnson v. M’Intosh*, 21 U.S. 543 (1823); *Cherokee Nation v. Georgia*, 30 U.S. 1 (1831); and *Worcester v. Georgia*, 31 U.S. 515 (1832) (collectively called the “Marshall Trilogy”).

² *Cherokee Nation v. Georgia*, 20 U.S. 1 (1831).

³ *Seminole Nation v. United States*, 316 U.S. 286, 296-97 (1942).

⁴ See Indian Self-Determination and Education Assistance Act of 1975, 25 U.S.C. § 5301 *et seq.* (1975)(emphasis added).

⁵ See e.g., Indian Trust Asset Reform Act, 25 U.S.C. § 5601 (2016). Congress finds that:

- 1) there exists a unique relationship between the Government of the United States and the governments of Indian tribes;
- 2) there exists a unique Federal responsibility to Indians;
- 3) through treaties, statutes, and historical relations with Indian tribes, the United States has undertaken a unique trust responsibility to protect and support Indian tribes and Indians;
- 4) the fiduciary responsibilities of the United States to Indians also are founded in part on specific commitments made through written treaties and agreements securing peace, in exchange for which Indians have surrendered claims to vast tracts of land, which provided legal consideration for permanent, ongoing performance of Federal trust duties; and
- 5) the foregoing historic Federal-tribal relations and understandings have benefitted the people of the United States as a whole for centuries and have established enduring and enforceable Federal obligations to which the national honor has been committed.

Tribal Economic Governance and Dual Taxation

As an exercise of self-governance, tribal nations provide their citizens and surrounding communities a broad range of governmental services including: education, law enforcement, emergency management, judicial systems, healthcare, energy, social services, employment, natural resource management, and the development and maintenance of infrastructure such as roads, bridges, sewers, telecommunications, broadband, and electrical services.

Like all sovereigns, tribal nations need revenues to fund governmental services and public goods. The Supreme Court has recognized the application of this inherent governmental authority to tribal nations and held that:

The power to tax is an essential attribute of Indian sovereignty because it is a necessary instrument of self-government and territorial management. This power enables a tribal government to raise revenues for its essential services. The power...derives from the tribe's general authority, as sovereign, to control economic activity within its jurisdiction, and to defray the cost of providing governmental services by requiring contributions from persons or enterprises engaged in economic activities within that jurisdiction.⁶

Despite the Supreme Court's recognition of tribal taxation authority, taxation of economic activities on tribal lands is often subject to attempts by state and local governments to tax the same economic activity, which results in complex, confusing, and unpredictable rules. This dual taxation creates disincentives to invest in businesses on tribal lands and results in tribal nations often foregoing their inherent right to tax in order to retain private investment on their lands. This forfeiture of critical revenue contributes to the distressed economic conditions that exist on many tribal lands. According to a 2018 report by the independent and bipartisan United States Commission on Civil Rights (USCCR) titled, *Broken Promises: Continuing Federal Funding Shortfall for Native Americans*:

Indian Country faces many economic development challenges. Over 25 percent of Native Americans live in poverty, which is higher than the poverty rate of any other racial group in the U.S...For Native Americans living on reservations, the unemployment rate is around 50 percent and for certain reservations, the average unemployment rate is much higher, hovering around 80 percent and up.⁷

Indian Country has long pursued solutions⁸ to dual taxation and recently passed NCAI Resolution [#ABQ-19-015](#), titled *Urging the Secretary of the Treasury to Assist in Ending Dual Taxation of Economic Activity in Indian Country*. Due to dual taxation, generation of revenue through tribal economic development and achieving governmental parity under the Tax Code are especially critical in order to sustain tribal economies and communities.

⁶ *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 137 (1982) (emphasis added).

⁷ U.S. Commission on Civil Rights, *Broken Promises: Continued Federal Funding Shortfall for Native Americans*, <https://www.usccr.gov/pubs/2018/12-20-Broken-Promises.pdf>.

⁸ [#SAC-12-042](#) *Supporting Solutions, Including Federal Legislation if Necessary, that Will Reverse or Mitigate the Effects of the 1989 Decision of the U.S. Supreme Court in the Case of Cotton Petroleum V. New Mexico*; [#SD-15-045](#) *Urging the Department of Interior to Address the Harms of State Taxation in Indian Country and Prevent Dual Taxation of Indian Communities*; and [#DEN-18-018](#) *Urging the Department of the Interior to Restart its Process of Updating the "Licensed Indian Trader" Regulations*.

Tribal Nations and Governmental Parity

Like all governments within the United States, tribal nations are immune from federal income tax liability.⁹ Further, Section 7871(a) of the Tax Code and Section 305.7871-1 of the Income Tax Regulations provide that tribal nations (or subdivisions thereof) will be treated as states for certain federal tax purposes. While these rulings and sections are beneficial, they provide only a modest measure of parity with other governments under the Tax Code.

Currently, the Tax Code does not provide tribal nations many of the benefits, incentives, and protections available to state and local governments. This disparity places tribal nations at a disadvantage when it comes to providing for the health, safety, and wellbeing of their communities. To begin addressing inequalities in the Tax Code and increase access to capital, Indian Country has long asked that Congress pass legislation that provides, at a minimum, equity with state and local governments.

The following sections present several longstanding tribal tax priorities.

Adoption Tax Credit¹⁰

Tribal nations have jurisdiction over adoption proceedings involving their citizens. The Indian Child Welfare Act of 1978 (ICWA) expresses a congressional preference for tribal jurisdiction over custody proceedings involving tribal children in order to “protect the best interests of Indian children” and to “promote the stability and security of Indian tribes and families.”¹¹

Congress created the adoption tax credit (ATC) to mitigate the financial burden experienced by families adopting children and incentivize adoptions of children who might otherwise be difficult to place in adoptive homes. The ATC allows parents to claim a credit of up to \$10,000 adjusted for inflation. Parents who adopt a child with “special needs” – as determined by a court with jurisdiction over the adoption – are eligible to claim the full adoption tax credit without having to document qualified upfront adoption expenses.

Currently, Section 23 of the Tax Code only allows states to designate children as “special needs.”¹² Due to this limitation, taxpayers who adopt a child designated as special needs in state court can claim the ATC while adoptive families in tribal court cannot.

Solution: A simple legislative fix that inserts “Indian tribal government” after “a State” in Section 23, would address this inequity which subjects tribal adoptive families to increased tax burdens in the already expensive adoption process. Such a minor fix would effectuate the purpose of the ATC and also aid Congress’ policy of supporting the restoration, stability, and security of tribal nations and families.

⁹ See e.g., Rev. Rul. 67-284; Rev. Rul. 94-16.

¹⁰ [#ABQ-19-081](#) *Calling on Congress to Immediately Enact Legislation to Provide Tribal Nations Tax Parity and Spur Tribal Economic Development*.

¹¹ 25 U.S.C. § 1902.

¹² 26 U.S. Code § 23(d)(3) (considerations include “age; membership in a minority or sibling group; ethnic background; medical condition; or physical, mental, and emotional handicaps”).

Tribal Foundations and Charities¹³

Tribal charities provide assistance to communities across Indian Country. Presently, the Tax Code treats tribal nations like corporations rather than like state and local governments when they fund charities that serve public purposes.

Every Section 501(c)(3) charitable organization is treated as either a public charity or a private foundation. Public charity classification is generally based on an organization's sources of funding or support.¹⁴ It may also be based on whether the organization was formed to support a particular type of organization, such as a state or local government.¹⁵ In comparison to public charities, private foundations have lower deductibility limits for donors and annual asset distribution requirements.¹⁶

Presently, the Tax Code does not address the public charity status of Section 501(c)(3) organizations that are established or funded by tribal nation. This means that financial support from a tribal nation is not treated as support from a governmental entity for a public charity classification. Likewise, organizations formed to support state and local governments are treated as "supporting organizations" for purposes of public charity classifications, but the status of organizations formed to support tribal nations is unclear.

This unintended disparity under the public charity classification rules makes it difficult for tribal nations to form and fund Section 501(c)(3) nonprofit organizations outside of private foundations. This limits the ability of tribal nations to leverage tribal resources and raise additional charitable dollars from private foundations, corporations, and individual donors as states and local governments effectively do to run schools, hospitals, and other public-serving institutions.

Solution: A simple fix for this issue would entail treatment of tribal funding as public support for purposes of Section 170(b)(1)(A)(vi) and treatment of charitable organizations formed to support tribal nations the same as those formed to aid other governments for purposes of Section 509(a)(3).

Tax Fairness for Tribal Youth¹⁷

For several decades, the Tax Code has mistakenly and unfairly forced tribal children and young adult students to pay upwards of four times the tax rate that tribal adults pay on the same amount of taxable distributions for support funds paid by tribal nations to tribal citizens.

This so-called "kiddie tax penalty" has never been intended to target tribal payments to tribal youth. Instead, its purpose is to discourage wealthy taxpayer parents from shifting income-producing assets to their children in lower tax brackets, thereby curbing tax avoidance by these wealthy parents. Tribal nations, on the other hand, are immune from income tax. So, there cannot be any tax avoidance purpose behind a taxable tribal distribution. Nevertheless, the broad definition of

¹³ [#ABQ-19-081](#) *Calling on Congress to Immediately Enact Legislation to Provide Tribal Nations Tax Parity and Spur Tribal Economic Development.*

¹⁴ 26 U.S.C. § 509(a)(1)-(2).

¹⁵ 26 U.S.C. § 509(a)(3).

¹⁶ See IRS Publication: Charitable Contribution Deductions at <https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions> (2019); 26 U.S. Code § 4942;

¹⁷ [#ABQ-19-084](#) *Calling on Congress to Provide Tax Fairness for Tribal Youth.*

“unearned income” used in the “kiddie tax penalty” statute has unintentionally been applied to transfers to tribal youth from tax immune, non-taxpayer tribal nations.

Under the “kiddie tax penalty” rules, a college student under the age of 24 pays several times more tax than does his or her sibling age 24 years or older on the same tribal support payment, unless the student drops out of college or marries. Moreover, tribal children – once they reach the age of majority and can draw down their minor’s trust fund accounts that have received and held their annual tribal distributions – must pay tax on withdrawals at much higher rates than their siblings and parents on the same distributions.

Some examples reveal the unfairness of the application of the “kiddie tax penalty” on tribal distributions to young tribal citizens. Take the case of a 23-year-old tribal student receiving \$1,000/month for college living expenses compared to how current law taxes her 24-year-old brother who receives the same per capita amount, assuming their parents are both employed with working class incomes. After deductions, the 23-year-old student is taxed \$2,616 (at an effective tax rate of 21.8 percent), but her 24-year-old brother is taxed \$0 on his identical \$1,000/month tribal distribution. If the per capita amounts increase to \$2,000 a month, the 23-year-old student is taxed at an effective rate over four times her older brother on the same per capita income. At higher amounts, the student is taxed at an effective rate of about two times her older brother. The harshest consequences are borne by youthful tribal citizens whose tribal nations distribute relatively modest per capita payments.

While Congress enacted a “partial fix” in the SECURE Act in late 2019 by lowering the highest tax rates, it left unaddressed the unintended application of the pre-2018 “kiddie tax penalty” rate structure that combines its far lower deduction ceilings and parental tax rates to most tribal transfers to tribal children, youth, and young adults. The result creates a lack of parity of treatment between tribal citizens that unfairly penalizes younger citizens and students.

Solution: The provisions of H.R. 2810 should be added to the package of tribal tax reform measures under consideration by the 116th Congress and enacted. H.R. 2810 would amend Section 1(g) of the Tax Code to expressly exclude the transfer of funds by a tribal nation to young tribal members from the so-called “kiddie tax penalty” structure.

Child Support Enforcement¹⁸

Federal collection of child support utilizes two programs: the Federal Parent Locator Service (FPLS) and the Federal Income Tax Refund Offset Program (Offset Program). The FPLS is an assembly of systems that assists governments in locating non-custodial parents for the establishment of paternity and child support obligations, as well as the enforcement and modification of orders for child support, custody, and visitation.

The Preventing Sex Trafficking and Strengthening Families Act of 2014, Section 302, amended the Social Security Act (SSA) to provide authority for tribal nations to access the FPLS to improve child support collections by tribal nations. However, this amendment did not address tribal access to the Offset Program.

¹⁸ [#MOH-17-011](#) *Equitable Treatment for Tribal Nations in Congressional Tax Reform.*

The Offset Program is governed by Section 664 of the SSA and Section 6402(c) of the Tax Code, which authorize the Department of the Treasury to withhold from tax refunds amounts owed for past due child support payments. Section 664 and Section 6402(c) reference only state child support collection agencies and thus result in an unintended exclusion of tribal nations from this critical support collection tool.

Solution: Permit tribal nations to participate in the Federal Income Tax Refund Offset Program under Section 664 of the SSA and Section 6402(c) of the Tax Code.

Additional Longstanding Tribal Tax Priorities

In addition to the issues spotlighted above, Indian Country has also long advocated for the following tax priorities:

- **Tax-Exempt Bond Parity:**¹⁹ State and local governments can issue tax-exempt bond debt for commercial activity to raise revenue. In contrast, tribal nations are permitted to only issue bonds for essential government functions and not economic development activity. This restricts economic stimulus and limits bond market access for tribal nations.
- **Indian Employment Tax Credit Improvement:**²⁰ The Indian Employment Tax Credit incentivizes job creation on tribal homelands. Simplifying, expanding, and making permanent the Indian Employment Tax Credit would increase its deployment, thereby promoting economic growth and job creation on tribal homelands.
- **Low-Income Housing Tax Credits (LIHTC) Deployment:**²¹ LIHTC provides tax incentives, via states, to developers to create affordable housing. Tribal nations have been disproportionately left out of this program and seek increased deployment in Indian Country by – at a minimum – being included in the program’s allocation criteria.
- **New Markets Tax Credits (NMTC) Deployment:**²² The NMTC Program attracts private capital to economically distressed communities by providing tax credits to investors. The rate of NMTC deployment in Indian Country is low. Incentives – such as a proportional allocation modeled after the rural allocation – would begin to address this issue by bringing much-needed capital investment in tribal infrastructure and employment opportunities into Indian Country.
- **Parity for Indian Health Service Health Professionals:** Indian Health Service health professionals are ineligible for tax incentives available to other public sector

¹⁹ [#ABQ-19-081](#) *Calling on Congress to Immediately Enact Legislation to Provide Tribal Nations Tax Parity and Spur Tribal Economic Development.*

²⁰ *Id.*

²¹ *Id.*

²² [#ABQ-19-020](#) *Support for Legislative Efforts to Increase Tribal Access to New Markets Tax Credits; #ABQ-19-081* *Calling on Congress to Immediately Enact Legislation to Provide Tribal Nations Tax Parity and Spur Tribal Economic Development.*

health professionals. The Indian Health Service should have the same recruitment and retention tax incentives as other public sector health systems.

- **Tribal General Welfare Exclusion Act (TGWEA) Clarification:**²³ The TGWEA excludes from gross income, for income tax purposes, the value of a tribal general welfare benefit. An amendment is needed to clarify that these benefits are excluded from income for a social security eligibility determination and any determination for federal benefits programs.
- **Government Pensions Parity:**²⁴ Unlike other governments, the Tax Code requires tribal nations to have separate types of pension plans (government and private) based on an employee’s job activities. This inequity results in increased monetary and compliance costs for tribal nation employers. Like all governments, tribal nations must be able to operate a single, comprehensive, government pension plan for all their employees.
- **Excise Taxes Parity:**²⁵ Tribal nations are not treated the same as state and local governments for a variety of excise tax exemptions, which diverts resources from government services for tribal citizens. Congress should remove the “essential government functions” limitation and permit tribal nations to receive the same exemption from federal excise taxes as those afforded to state and local governments.

Conclusion

NCAI strongly supports passage of legislation to provide governmental tax parity and increase access to capital for tribal nations. Thank you for the opportunity to testify regarding the impact of the Tax Code on tribal nations. I look forward to working with this Subcommittee and the Ways and Means Committee on a bipartisan basis to advance legislation that reflects the United States’ trust and treaty responsibilities to support the inherent rights of tribal nations to provide for the social and economic welfare of their citizens and surrounding communities.

²³ [#MOH-17-019](#) *Requesting Agencies to Comply with the Tribal General Welfare Exclusion Act, PL 113-168, by Recognizing the Treatment of Income for Purposes of Benefits Eligibility.*

²⁴ [#MOH-17-011](#) *Equitable Treatment for Tribal Nations in Congressional Tax Reform.*

²⁵ *Id.*, and [#SD-15-036](#) *Support for Tribal Tax Reform and Setting Tax Policy Priorities.*