

**OVERVIEW OF FEDERAL TAX PROVISIONS RELATING  
TO NATIVE AMERICAN TRIBES AND THEIR MEMBERS**

Scheduled for a Public Hearing  
Before the  
SENATE COMMITTEE ON FINANCE  
on July 22, 2008

Prepared by the Staff  
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JOINT COMMITTEE ON TAXATION



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## INTRODUCTION AND SUMMARY

The Senate Committee on Finance has scheduled a public hearing for July 22, 2008, on selected Federal tax issues relating to Native American tribes and Native Americans. This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of Federal tax law relating to Native American<sup>2</sup> tribes and their members as well as data on the economic status of Native American tribes and Native Americans in the United States.

Native American households are among the most economically disadvantaged in the United States. According to 2000 U.S. Census data, the median income of a Native American household was \$31,600, compared to \$44,700 for the U.S. population as a whole. In 2003, 49 percent of work-eligible Native Americans were unemployed; of the 51 percent who were employed, 32 percent earned income below the poverty line. Overall, 25 percent of Native Americans live in poverty, compared to nine percent for the U.S. white population. Although gaming operations have become an increasingly important source of revenue and employment for tribes and their members, a large percentage of Native Americans continue to suffer from difficult economic conditions.<sup>3</sup>

Some commentators have argued that uncertainties about the taxation of transactions in Indian country<sup>4</sup> have inhibited economic development, contributing significantly to economic plight of tribes and their members.<sup>5</sup> Investors doing business in Indian country must contend with three tax systems – Federal, State, and tribal – often with uncertain application. Mark J. Cowan, for example, has argued that tribes and States both have the power to tax certain transactions of non-members of tribes within Indian country, resulting in double taxation of such transactions and a disincentive to invest in business ventures on reservations.<sup>6</sup> Cowan argues

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Overview of Federal Tax Provisions Relating to Native American Tribes and Their Members* (JCX-61-08), July 18, 2008. This document can be found on the Internet at [www.jct.gov](http://www.jct.gov).

<sup>2</sup> The laws regarding Native Americans generally use the term “Indian.” This pamphlet uses the terms Native American and Indian interchangeably.

<sup>3</sup> See Part III for a more detailed discussion of the economic status of Native Americans in the United States.

<sup>4</sup> Indian country generally includes formal and informal reservations, dependent Indian communities, and Indian allotments. See, e.g., *Oklahoma Tax Comm’n v. Sac & Fox Nation*, 508 U.S. 114 (1993).

<sup>5</sup> See, e.g., Erik M. Jensen, *Taxation and Doing Business in Indian Country*, 60 *Maine Law Review* 1, 3 (2008); Mark J. Cowan, *Double Taxation in Indian Country: Unpacking the Problem and Analyzing the Role of the Federal Government in Protecting Tribal Governmental Revenues*, 2 *Pittsburgh Tax Review* 93, 101 (2005).

<sup>6</sup> Mark J. Cowan, *Double Taxation in Indian Country: Unpacking the Problem and Analyzing the Role of the Federal Government in Protecting Tribal Governmental Revenues*, 2 *Pittsburgh Tax Review* 93, 94, 101 (2005).

that the status of tribes “does not fit neatly into the category of a ‘state’ or a ‘foreign nation,’” and thus “traditional concepts and mechanisms for avoiding double taxation that have developed in other multi-jurisdictional settings are not easily imported into Indian country.”<sup>7</sup> Erik M. Jensen has argued that outside capital is essential to economic development in Indian country, but, because of the uncertain application of the tax laws, such investment sometimes is viewed as excessively risky.<sup>8</sup>

Part I of this pamphlet provides an overview of the Federal and State taxation of Indian tribes and their members and of the taxing powers of Indian tribes. Indian tribes generally are exempt from Federal income tax and, in the absence of Congressional consent, generally are exempt from State income tax. With limited exceptions, enrolled members of Indian tribes are subject to Federal income tax, but generally are exempt from State income tax unless Congress consents to such taxation. Indian tribes have an inherent sovereign power to tax transactions that occur on certain Indian lands and that significantly involve the tribe or its members. Part I also discusses the special, favorable tax treatment of Alaska Native Settlement Trusts established to promote the health, education, and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.

Part II discusses several special rules regarding the taxation of Indian tribes or their members and the taxation of income from certain activities conducted by Indian tribes or on Indian reservations. For example, under section 7871 of the Internal Revenue Code, Indian tribes explicitly are afforded the more favorable treatment of U.S. States for certain purposes under the Federal tax laws. These purposes include, among others, the ability to receive deductible charitable contributions, in some cases the ability to issue tax exempt bonds and private activity bonds, and special treatment under certain Federal excise taxes. Part II also describes tax rules relating to gambling operations, which as indicated above, now produce significant revenue for many Indian tribes. Part II then describes several tax rules designed to encourage economic development on Indian reservations, including: (1) accelerated depreciation rules for property on Indian reservations; (2) the Indian employment tax credit; and (3) the treatment of Indian reservations as empowerment zones or renewal communities eligible for special tax incentives. Part II also describes various other special income and employment tax rules.

Part III provides statistical information regarding Native Americans in the United States, including information concerning the economic conditions and population of Native Americans.

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<sup>7</sup> *Id.* at 94.

<sup>8</sup> Erik M. Jensen, *Taxation and Doing Business in Indian Country*, 60 *Maine Law Review* 1, 3 (2008)

# I. GENERAL RULES REGARDING THE TAXATION OF INDIAN TRIBES AND TRIBAL MEMBERS AND THE TAXING POWERS OF INDIAN TRIBES

## A. Income Taxation of Indian Tribes and Wholly Owned Tribal Corporations

### 1. U.S. income taxation of Indian tribes

No specific Code provision governs the U.S. income tax liability of Indian tribes. However, the Internal Revenue Service (“IRS”) has long taken the position that Indian tribes and wholly owned tribal corporations chartered under Federal law or the Oklahoma Indian Welfare Act are not taxable entities for U.S. income tax purposes and are immune from U.S. income taxes, regardless of whether the activities that produced the income are commercial or noncommercial in nature or are conducted on or off the tribe’s reservation.<sup>9</sup> In contrast, a corporation organized under State law and owned by a tribe or tribal members may be subject to U.S. income tax on income earned from activities conducted on or off the tribe’s reservation.<sup>10</sup>

Since the Indian Tribal Government Tax Status Act of 1982,<sup>11</sup> section 7871 has expressly provided that Indian tribal governments are treated as States for certain tax purposes. These purposes are discussed in Part II below.

### 2. State taxation of Indian tribes

Tribal governments and corporations generally are exempt from State taxation within their reservations, and remain so unless Congress clearly manifests its consent to such taxation.<sup>12</sup> The United States Supreme Court held that Congress consented to State ad valorem real property taxes on Indian land from which limitations on alienation were removed through the issuance of a fee patent.<sup>13</sup> Accordingly, land owned in fee by a tribe is generally subject to State property

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<sup>9</sup> See, e.g., Rev. Rul. 94-65, 1994-2 C.B. 14; Rev. Rul. 94-16, 1994-1 C.B. 19; Rev. Rul. 81-295, 1981-2 C.B. 15; Rev. Rul. 67-284, 1967-2 C.B. 55. Legal commentators generally have concluded that under the “so-called Indian Commerce Clause [article I, section 8 of the Constitution] and Supreme Court cases, there is little constitutional limitation on the ability of the Federal government to tax Indian tribes or tribal members.” Ellen P. Aprill, *Tribal Bonds: Indian Sovereignty and the Tax Legislative Process*, 46 Administrative Law Review 333, 334 (1994). The Supreme Court has never held unconstitutional a Federal tax applied to Indians. See *Lac Courte Oreilles Band of Lake Superior Chippewa Indians v. United States*, 845 F.2d 139, 143 (7<sup>th</sup> Cir. 1988); *Chickasaw Nation v. United States*, 208 F.3d 871, 880 (10<sup>th</sup> Cir. 2000).

<sup>10</sup> Rev. Rul. 94-16, 1994-12 I.R.B. 1; Rev. Rul. 94-65, 1994-42 I.R.B. 10.

<sup>11</sup> Pub. L. No. 97-473, 96 Stat. 2605 (1983).

<sup>12</sup> *Oklahoma Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450 (1995); *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759 (1985); *McClanahan v. Arizona State Tax Comm’n*, 411 U.S. 164 (1973); *Cass County, Minn., v. Leech Lake Band of Chippewa Indians*, 524 U.S. 103 (1998) (explained below).

<sup>13</sup> *County of Yakima v. Confederated Tribes & Bands of the Yakima Indian Nation*, 502 U.S. 251, 253-56 (1992) (finding a clear manifestation by Congress to permit such taxation in the Indian General

taxes whether located within or outside of Indian country,<sup>14</sup> even if the land had been formerly held in trust for the tribe.<sup>15</sup> Congress has not consented to all taxes on property. States may not apply a property tax to allotted lands held in trust for a tribe by the Federal government, and States may not apply an excise tax upon the sale of any interest in land within an Indian reservation.<sup>16</sup>

Tribal governments generally are taxable by States on income earned outside of their reservations.<sup>17</sup> However, any land or right acquired by the United States in trust for a tribe pursuant to the Indian Reorganization Act<sup>18</sup> is exempt from State taxes, even if the land or right so acquired is located outside of a reservation.<sup>19</sup>

States may impose sales and excise taxes on sales or activities within an Indian reservation if the legal incidence of the tax rests on persons who are not tribal members, the

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Allotment Act of 1887, 25 U.S.C. sec. 331 *et. seq.*, as amended by the Burke Act of 1906, 25 U.S.C. sec. 349).

<sup>14</sup> Land within Indian reservations generally is held either in trust by the Federal government for the benefit of a tribe or individual members of an Indian tribe, or owned in fee by either an Indian tribe, members of an Indian tribe, or non-Indian persons. Initially, Indian reservation land generally was held in trust by the Federal government for the benefit of Indians resident on the land. From the late 19<sup>th</sup> century until passage of the Indian Reorganization Act of 1934, 25 U.S.C. sec. 461 *et seq.*, the Federal government allotted certain Indian lands to individual members of an Indian tribe and after a period of time issued fee patents to some of the allotted parcels. The recipient of a fee patent was free to sell the land, which has resulted in certain portions of Indian reservations presently being owned in fee by Indians, Indian tribes, and non-Indians. With the passage of the Indian Reorganization Act of 1934, Congress halted further allotments and extended indefinitely the existing period of trust applicable to already allotted, but not yet fee patented, Indian lands. See *County of Yakima v. Confederated Tribes & Bands of the Yakima Indian Nation*, 502 U.S. 251, 253-56 (1992).

<sup>15</sup> *Cass County, Minn. v. Leech Lake Band of Chippewa Indians*, 524 U.S. 103 (1998). A different case is presented in *Oneida Indian Nation v. City of Sherrill*, 145 F. Supp. 2d 226 (N.D.N.Y. 2001), where lands owned in fee by the tribe were held not to be subject to State property taxes because they were located within Indian country and Congress had not consented to taxation of the lands by the State. The lands in question had never been allotted to individual tribal members, but had been made alienable through a controversial course of conduct specific to the region in which the lands are situated.

<sup>16</sup> *County of Yakima v. Confederated Tribes & Bands of the Yakima Indian Nation*, 502 U.S. 251, 268-70 (1992).

<sup>17</sup> *Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973) (tribe held to be subject to State gross receipts tax on income earned from a ski resort operated by the tribe off-reservation).

<sup>18</sup> Indian Reorganization Act, ch. 576, 25 U.S.C. sec. 461 *et seq.* (1934).

<sup>19</sup> *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 155-59 (1973). The exemption under the Indian Reorganization Act extends to bar a compensating use tax on personal property permanently attached to realty, but does not bar an income tax or a non-discriminatory gross receipts tax on income derived from a business conducted using the property. *Id.* at 158.

balance of Federal, State, and tribal interests favors the State, and minimal burdens in collecting the tax are imposed on a tribe or tribal members.<sup>20</sup> Two cases illustrate the limits of State power to apply a tax upon persons who are not tribal members engaged in business in Indian country. First, a State may not apply a motor carrier license fee or fuel use tax on a non-Indian logging company's use of reservation roads where the logging was pursuant to a comprehensive Federal regulatory scheme and the roads used were maintained entirely by the tribe and the Federal government.<sup>21</sup> Second, a State may not apply a gross receipts tax to a non-tribal member's construction firm that was employed to build a school for a tribe, when the school was to be financed and operated by the tribe and the Federal government.<sup>22</sup>

Income from mineral royalty interests is exempt from State taxation if it is derived by a tribe from the lease of unallotted reservation land and entered into under the Indian Mineral Leasing Act of 1938.<sup>23</sup> However, States may apply production taxes to the exploitation of mineral interests by non-Indians pursuant to such a lease, whether or not the value obtainable by a tribe for the mineral lease is affected.<sup>24</sup> But, States may not apply production taxes that are so high as to have a significant negative effect on the marketability of a tribe's product.<sup>25</sup>

## **B. Tax Treatment of Enrolled Members of Indian Tribes**

### **1. Federal tax**

Ordinarily, individual members of Indian tribes are subject to Federal income taxes, even if the income is distributed to individual tribal members out of income otherwise immune from taxation when first received by the tribe.<sup>26</sup>

Certain types of income earned by members of Indian tribes are not subject to Federal tax. One such type is income earned from the exercise of certain fishing rights, explained below. Also excluded from tax are payments in satisfaction of a judgment of the United States Court of

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<sup>20</sup> *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Ok.*, 498 U.S. 505 (1991) (upholding State cigarette sales tax on sales to non-members of the tribe); *Cotton Petroleum v. New Mexico*, 490 U.S. 163 (1989) (upholding imposition of State severance tax on private producers of oil and gas on reservation lands); *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 459-60 (1995).

<sup>21</sup> *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980).

<sup>22</sup> *Ramah Navajo School Bd. Inc. v. Bureau of Revenue of N.M.*, 458 U.S. 832 (1982).

<sup>23</sup> *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759 (1985).

<sup>24</sup> *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 186-87 (1989).

<sup>25</sup> *Montana v. Crow Tribe*, 484 U.S. 997 (1988), *summarily aff'g* 819 F.2d 895 (9<sup>th</sup> Cir. 1987), *explained in Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 187 (1989).

<sup>26</sup> *Squire v. Capoeman*, 351 U.S. 1, 6 (1956). Per capita payments of net revenues from gaming activities conducted or licensed by any Indian tribe are specifically made subject to Federal taxes by the Indian Gaming Regulatory Act, 25 U.S.C. sec. 2710(b)(3)(D), Pub. L. No. 100-497 (Oct. 17, 1988).

Federal Claims in favor of an Indian tribe that are distributed per capita to tribal members pursuant to a plan approved by the Secretary of the Interior,<sup>27</sup> and per capita distributions made to tribal members from certain Indian trust funds.<sup>28</sup> A third type of income excluded is income derived directly from land held in trust by the Federal government for the benefit of a tribe or a member of an Indian tribe.<sup>29</sup> Income is derived directly from trust land if it is generated principally from the use of reservation land and resources rather than from capital improvements upon the land, and includes income from logging, mining, farming, or ranching activities.

## 2. State tax

Individual members of an Indian tribe that reside in Indian country are exempt from State taxes, unless Congress clearly manifests its consent to such taxation.<sup>30</sup> Members of an Indian tribe who reside outside of a reservation are subject to State taxes on income, regardless of whether the income was derived from within an Indian reservation.<sup>31</sup>

As explained above, States may not apply a property tax to allotted lands held in trust for a tribe or members of a tribe by the Federal government, and may not apply an excise tax upon the sale of any land within an Indian reservation. However, States may apply real property taxes to property that is owned in fee by an Indian or persons who are not tribal members within reservations. In addition, States may require tribal members to collect sales taxes on sales made to non-members of the tribe.<sup>32</sup>

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<sup>27</sup> 25 U.S.C. secs. 1401-1407.

<sup>28</sup> 25 U.S.C. sec. 117b(a). A special rule, described below, governs distributions from an Alaska Native Settlement Trust.

<sup>29</sup> *Squire v. Capoeman*, 351 U.S. 1 (1956). A number of courts have held that the exclusion is only available for income derived from land allotted to the individual earning the income and is not available for income derived from land leased from the tribe or another individual to whom the land is allotted. *Kieffer v. Comm'r*, T.C. 1998-202; *Anderson v. United States*, 845 F.2d 206 (9<sup>th</sup> Cir. 1988); *Holt v. Comm'r*, 364 F.2d 38 (8<sup>th</sup> Cir. 1966); *but see Campbell v. Comm'r*, T.C. Memo 1997-502 at 19. The exclusion does not extend to income derived from the reinvestment of income derived from allotted land. *Capoeman*, 351 U.S. at 9.

<sup>30</sup> *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450 (1995); *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759 (1985); *McClanahan v. Arizona State Tax Comm'n*, 411 U.S. 164 (1973).

<sup>31</sup> *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462-67 (1995).

<sup>32</sup> *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Ok.*, 498 U.S. 505 (1991). Enforcement of State sales taxes on transactions occurring on Indian lands has caused difficulties and controversy. These problems are described in *Santa Fe Natural Tobacco Co. v. Spitzer*, 2001 U.S. Dist. LEXIS 7548 (S.D.N.Y. June 8, 2001). According to the *Santa Fe Natural Tobacco* decision, attempts by New York State to collect sales taxes from sales to non-Indians by retailers located on reservations resulted in retailers and tribal members blockading roads, in threats of violence, and in actual violence. New York State relented and ceased efforts to collect sales taxes from retailers located on reservations, and instead passed a law prohibiting cigarette sellers from shipping or transporting cigarettes directly to

### C. Taxing Powers of Indian Tribes

Indian tribes have an inherent sovereign power to tax transactions occurring on Indian lands held in trust that significantly involve the tribe or its members.<sup>33</sup> For transactions occurring on lands not held in trust within an Indian reservation, a tribe generally may tax its members, but may not tax non-members unless it has civil authority over the non-members.<sup>34</sup> Without an express grant of civil authority by Congress, a tribe may only exercise civil authority over non-members in two cases: (1) if non-members have entered consensual relationships with the tribe or tribal members, and (2) if the conduct of non-members threatens or has some direct effect on the political integrity, economic security, or the health and welfare of the tribe.<sup>35</sup> A non-member's conduct of a business on land owned in fee within a reservation is not itself a sufficient basis for the exercise of civil authority by a tribe.<sup>36</sup>

### D. Alaska Native Settlement Trusts (secs. 646 and 6039(H))

The Alaska Native Claims Settlement Act ("ANCSA")<sup>37</sup> established Alaska Native Corporations to hold property for Alaska Natives. Alaska Natives are generally the only permitted common shareholders of those corporations under section 7(h) of ANCSA, unless an Alaska Native Corporation specifically allows other shareholders under specified procedures.

ANCSA permits an Alaska Native Corporation to transfer money or other property to an Alaska Native Settlement Trust ("Settlement Trust") for the benefit of beneficiaries who constitute all or a class of the shareholders of the Alaska Native Corporation, to promote the health, education and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.<sup>38</sup>

Alaska Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, are generally subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, or beneficiaries.

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New York consumers and prohibiting common carriers from delivering cigarettes directly to New York consumers. The court held that the law was prohibited as a violation of the dormant commerce clause, and as an interference with the exclusive Federal power to regulate the United States Postal Service.

<sup>33</sup> *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982).

<sup>34</sup> *Montana v. United States*, 450 U.S. 544 (1981).

<sup>35</sup> *Id.*

<sup>36</sup> *Atkinson Trading Co. v. Shirley*, 532 U.S. 645 (2001) (tribe held not to have authority to apply a hotel occupancy tax on a hotel owned by non-members on land held in fee located within a reservation).

<sup>37</sup> 43 U.S.C. 1601 *et. seq.*

<sup>38</sup> With certain exceptions, once an Alaska Native Corporation has made a conveyance to a Settlement Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgment, except with respect to the lawful debts and obligations of the Settlement Trust.

Special tax rules enacted in 2001 allow an election to use a more favorable tax regime for transfers of property by an Alaska Native Corporation to a Settlement Trust and for income taxation of the Settlement Trust. There is also simplified reporting to beneficiaries.

Under the special tax rules, a Settlement Trust may make an irrevocable election to pay tax on taxable income at the lowest rate specified for individuals, (rather than the highest rate that is generally applicable to trusts) and to pay tax on capital gains at a rate consistent with being subject to such lowest rate of tax. As described further below, beneficiaries may generally thereafter exclude from gross income distributions from a trust that has made this election. Also, contributions from an Alaska Native Corporation to an electing Settlement Trust generally will not result in the recognition of gross income by beneficiaries on account of the contribution. An electing Settlement Trust remains subject to generally applicable requirements for classification and taxation as a trust.

A Settlement Trust distribution is excludable from the gross income of beneficiaries to the extent of the taxable income of the Settlement Trust for the taxable year and all prior taxable years for which an election was in effect, decreased by income tax paid by the Trust, plus tax-exempt interest from State and local bonds for the same period. Amounts distributed in excess of the amount excludable is taxed to the beneficiaries as if distributed by the sponsoring Alaska Native Corporation in the year of distribution by the Trust, which means that the beneficiaries must include in gross income as dividends the amount of the distribution, up to the current and accumulated earnings and profits of the Alaska Native Corporation. Amounts distributed in excess of the current and accumulated earnings and profits are not included in gross income by the beneficiaries.

A special loss disallowance rule reduces (but not below zero) any loss that would otherwise be recognized upon disposition of stock of a sponsoring Alaska Native Corporation by a proportion, determined on a per share basis, of all contributions to all electing Settlement Trusts by the sponsoring Alaska Native Corporation. This rule prevents a stockholder from being able to take advantage of a decrease in value of an Alaska Native Corporation that is caused by a transfer of assets from the Alaska Native Corporation to a Settlement Trust.

The fiduciary of an electing Settlement Trust would be obligated to provide certain information relating to distributions from the trust in lieu of reporting requirements under Section 6034A.

The election to pay tax at the lowest rate is not available in certain disqualifying cases: (a) where transfer restrictions have been modified either to allow a transfer of a beneficial interest that would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act if the interest were Settlement Common stock, or (b) where transfer restrictions have been modified to allow a transfer of any Stock in an Alaska Native Corporation that would not be permitted by section 7(h) if it were Settlement Common Stock and the Alaska Native Corporation thereafter makes a transfer to the Trust. Where an election is already in effect at the time of such disqualifying situations, the special rules applicable to an electing trust cease to apply and rules generally applicable to trusts apply. In addition, the distributable net income of the trust is increased by undistributed current and accumulated earnings and profits of the trust, limited by the fair market value of trust assets at the date the trust becomes so disposable. The

effect is to cause the trust to be taxed at regular trust rates on the amount of recomputed distributable net income not distributed to beneficiaries, and to cause the beneficiaries to be taxed on the amount of any distributions received consistent with the applicable tax rate bracket.<sup>39</sup>

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<sup>39</sup> These provisions were enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 671 (June 7, 2001), scheduled to sunset in taxable years beginning after December 31, 2010. *See* H.R. Rep. No. 107-84 (2001).

## II. SELECTED FEDERAL TAX RULES RELATING TO INDIAN TRIBES AND THEIR MEMBERS

### A. Indian Tribal Governments Treated as States for Certain Purposes (sec. 7871)

Section 7871 expressly provides that Indian tribal governments are treated as States for certain tax purposes.<sup>40</sup> First, tribal governments may be recipients of deductible charitable donations for income, estate, and gift tax purposes. Second, tribal governments are extended the treatment provided to States under the following excise taxes: tax on special fuels, manufacturers excise taxes, communications excise tax, and tax on use of certain highway vehicles. Special treatment relating to excise taxes is available to tribal governments only with regard to transactions involving the exercise of an essential governmental function<sup>41</sup> by the Indian tribal government. Third, taxes paid to Indian tribal governments are deductible for income tax purposes to the same extent as State taxes. Fourth, Indian tribal governments may issue tax-exempt bonds and private activity bonds under certain conditions described further below.

Tribal governments may issue tax-exempt bonds in two general circumstances if they meet requirements applicable to States and certain other rules applicable only to tribes. Tribes may issue tax-exempt bonds for governmental purposes, subject to the requirement that substantially all of the proceeds of the issue are used in an essential governmental function.<sup>42</sup> Tribes also may issue private activity bonds to finance manufacturing facilities. A project financed by manufacturing facility bonds must meet requirements as to use, location and ownership, and employment. The use requirement provides that at least 95 percent of the net proceeds of the issue are to be used for the acquisition, construction, or improvement of property that is part of a manufacturing facility and subject to an allowance for depreciation. The location and ownership requirement provides that at least 95 percent of the net proceeds are to be used to

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<sup>40</sup> This provision was enacted by the Indian Tribal Government Tax Status Act of 1982, Pub. L. No. 97-473, sec. 202(a) (Jan. 4, 1983), *as amended* by the Deficit Reduction Act of 1984, Pub. L. No. 98-369, sec. 1065(a) (Aug. 18, 1984), and the Omnibus Reconciliation Act of 1987, Pub. L. No. 100-203 (Dec. 22, 1987).

<sup>41</sup> Section 7872(e) limits the term essential governmental function to exclude any function that is not customarily performed by State and local governments with general taxing powers. This provision was added by the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, sec. 10632(a) (Dec. 22, 1987). Prior to the enactment of this provision, the IRS interpreted the term essential governmental function to include any project for which Federal assistance to Indian tribes may be provided, including some commercial and industrial activities not generally conducted by States and local governments with general taxing powers. *See* H.R. Conf. Rep. No. 100-495 (1987). The power of States to issue tax-exempt bonds and State exemption from certain excise taxes is not conditioned upon the exercise of an essential governmental function, although activities of State governments are generally limited by State Constitutions or statutes. These limitations on State activities may be less stringent than the essential government function limitation applicable to Indian tribes.

<sup>42</sup> *See* above for a discussion of the essential governmental function requirement.

finance property to be located on qualified Indian lands of the issuer, which is to be owned and operated by the issuer.<sup>43</sup> The employment requirement provides that at time of issuance, it is reasonably expected that the aggregate face amount of private activity bonds financing a facility will not exceed 20 times the aggregate wages paid during a future calendar year. The employment requirement must be met each year beginning more than two years after the date of issuance. If the employment requirement is not met for any year for which it applies with respect to an issuance, all bonds that are part of that issuance cease to be tax-exempt to their holders. The annual tribal employment test is in lieu of an annual aggregate volume limit.<sup>44</sup>

In addition, Indian tribal governments are treated as States for purposes of: (1) unrelated business income tax rules that apply to State colleges and universities, (2) treatment of amounts received under a disability and sickness fund maintained by a State, (3) the rules relating to tax-sheltered annuities, (4) original discount rules, (5) the tax on excess expenditures to influence legislation, and (6) private foundation rules.<sup>45</sup>

## **B. Gaming Activities of Indian Tribes**

### **1. Overview**

Gaming activities have become a significant source of revenue for many Indian tribes. Such activities generally are regulated under the Indian Gaming Regulatory Act (“IGRA”),<sup>46</sup> which establishes a detailed regulatory, recordkeeping, and reporting regime for tribal gaming. Under the IGRA, the National Indian Gaming Commission has general oversight responsibility for Indian gaming. The IRS, however, has responsibility for Federal tax issues that relate to Indian gaming. This section discusses several of these Federal tax issues, including: (1) the taxation of income from gaming operations; (2) the tax treatment of gambling winnings and

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<sup>43</sup> Tribes may jointly finance a manufacturing facility, and the employment test may be met in such case by pro rata apportionment of wages by tribe according to the relative participation of each tribe.

<sup>44</sup> Manufacturing facility private activity bonds issued by tribes are not subject to State volume caps. *See* H.R. Conf. Rep. No. 100-495 (1987). Thus, the private activity bonds issued by tribes do not count against the volume cap of the State where the reservation is located. However, persons living on Indian reservations within a State are counted for purposes of calculating that State’s volume cap, thus, States could issue bonds for the benefit of tribal reservations located within the State.

<sup>45</sup> In the case of a tax-qualified retirement plan, an Indian tribal government generally is treated as if it is a governmental plan sponsor for purposes of special rules that apply to plans maintained by Federal, State, and local governments. Secs. 414(d), 415(b)(2)(H)(i), and 414(h)(2). However, an Indian tribal government generally is not treated as a governmental plan sponsor of a plan that covers employees who perform commercial activities (whether or not an essential government function). A similar rule applies under the Employee Retirement Income Security Act of 1974 (“ERISA”). Further, unlike State and local governments, an Indian tribal government is permitted to sponsor a plan that contains a qualified cash or deferral arrangement (a so-called “section 401(k) plan”). Section 401(k)(4)(B)(iii).

<sup>46</sup> 25 U.S.C. sec. 271, *et seq.*

losses, including withholding and reporting requirements; and (3) excise taxes on wagering activities.<sup>47</sup>

## **2. Federal tax treatment of income from gaming operations**

As is discussed above, Indian tribes and wholly owned tribal corporations chartered under Federal law generally are not subject to income tax. Therefore, gaming income of such tribes or tribal corporations generally is not taxable. A tribal corporation incorporated under State law may, however, be subject to tax on such income.

Under certain circumstances, the IGRA permits Indian tribes to make per capita distributions to members from revenue derived from certain gaming activities conducted or licensed by the tribe. The IGRA explicitly subjects the receipt of such distributions to Federal income tax.<sup>48</sup> Such distributions also are subject to special withholding requirements.<sup>49</sup>

## **3. Treatment of gambling winnings and losses**

Gains from wagering transactions are includible in a taxpayer's gross income. A taxpayer who itemizes deductions may deduct losses from wagering transactions, but only to the extent the taxpayer recognizes gains from such transactions on the taxpayer's income tax return.<sup>50</sup>

### **Withholding requirements**

In general, proceeds from a wagering transaction are subject to withholding at a rate of 25 percent if the proceeds exceed \$5,000 and are at least 300 times as large as the amount wagered.<sup>51</sup> In the case of sweepstakes, wagering pools, or lotteries, proceeds from a wager are subject to withholding at a rate of 25 percent if the proceeds exceed \$5,000, regardless of the

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<sup>47</sup> Certain forms of online gambling are prohibited by State or Federal law. The Department of Justice has taken the position that Internet gambling is prohibited by the Interstate Wire Act of 1961. *See, e.g.,* Letter from Michael Chertoff, Assistant Attorney General, to Dennis Neilander, Chairman of the Nevada Gaming Control Board (Aug. 23, 2002). In addition, in 2006 the U.S. Congress passed and the President signed the Unlawful Internet Gambling Enforcement Act of 2006, which generally makes financial institutions liable for processing certain illegal online gambling transactions. 31 U.S.C. sec. 5363(1)-(4).

<sup>48</sup> 25 U.S.C. sec. 2710(b)(3)(D), Pub. L. No. 100-497 (Oct. 17, 1988).

<sup>49</sup> Sec. 3402(r).

<sup>50</sup> Sec. 165(d).

<sup>51</sup> Sec. 3402(q)(3)(A).

odds of the wager.<sup>52</sup> In general, no withholding tax is imposed on winnings from bingo, keno, or slot machines.<sup>53</sup>

For withholding purposes, the proceeds from a wagering transaction are determined by subtracting the amount wagered from the amount received. Any non-monetary proceeds that are received are taken into account at fair market value.<sup>54</sup> Amounts paid with respect to identical wagers are treated as paid with respect to a single wager.<sup>55</sup>

### **Information reporting requirements**

Present law imposes information reporting requirements that enable the IRS to verify the correctness of taxpayers' returns. In general, every person engaged in a trade or business is required to file information returns for each calendar year for payments of \$600 or more made in the course of the payor's trade or business. Regulations provide generally that a gambling winning is reportable on Form W-2G only if the amount paid with respect to the wager is \$600 or more and the proceeds are at least 300 times the amount of the wager.<sup>56</sup>

Regulations describe special information reporting rules that apply for purposes of winnings from bingo, keno, and slot machines. Specifically, regulations provide that winnings (not reduced by the wager) of \$1,200 or more from bingo or slot machines, and winnings (reduced by the wager) of \$1,500 or more from keno, are subject to information reporting on Form W-2G, regardless of the odds of the wager.<sup>57</sup>

## **4. Wagering excise and occupational taxes**

Two excise taxes generally apply to wagering activities: a wagering tax and an occupational tax. The Code imposes a tax of 0.25 percent on any wager authorized under the law of the State in which the wager is accepted (the rate increases to 2.0 percent of any wager that is not so authorized).<sup>58</sup> Each person who is engaged in the business of accepting wagers is liable for the tax on all wagers placed with such person. Each person who conducts any wagering pool or lottery is liable for the tax on all wagers placed in such pool or lottery. Certain wagering activities conducted by States (sweepstakes, wagering pools, or lotteries) are exempt

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<sup>52</sup> Sec. 3402(q)(3)(B) and (C).

<sup>53</sup> Sec. 3402(q)(5). Gambling winnings, including winnings from bingo, keno, and slot machines, are subject to backup withholding under certain circumstances. Sec. 3406.

<sup>54</sup> Sec. 3402(q)(4).

<sup>55</sup> Treas. Reg. sec. 31.3402(q)-1(c)(1)(ii).

<sup>56</sup> Treas. Reg. sec. 31.3406(g)-2(d)(3).

<sup>57</sup> Treas. Reg. sec. 7.6041-1.

<sup>58</sup> Sec. 4401.

from these excise taxes.<sup>59</sup> Wagers placed in a coin-operated device, such as a slot machine, and certain wagers placed with State-licensed parimutual wagering enterprises also are exempt from the wagering tax.<sup>60</sup> Native American tribal governments are not treated as States for purposes of the wagering tax and related occupational tax.<sup>61</sup>

The Code also imposes an occupational tax of \$50 per year (\$500 in the case of persons accepting wagers not authorized by the law of the State in which the wager is accepted) for each person liable for the wagering tax and for each person who is engaged in receiving wagers for or on behalf of a person liable to pay the wagering tax.<sup>62</sup> In general, where multiple persons do business in co-partnership at any one place, only one occupational tax must be paid.<sup>63</sup>

Each person required to pay the occupational tax must register with the IRS. The registration must include: (1) the person's name and place of residence; (2) if such person is liable for the wagering excise tax, each place of business where the activity which makes him so liable is carried on, and the name and place of residence of each person who accepts wagers for such person or on his behalf; and (3) if he is engaged in accepting wagers for or on behalf of any person liable for the wagering excise tax, the name and place of residency of each such person.<sup>64</sup> The Code authorizes the Secretary to prescribe, by Treasury regulations, such supplemental information from persons required to register as may be needed to enforce the wagering provisions ("supplemental registration").<sup>65</sup> Pursuant to Treasury regulations, a supplemental registration must be filed if one of the following occurs: (1) the taxpayer changes either the business or home address; (2) the business of a deceased person who had paid the occupational tax is continued by the surviving spouse or child, executor, administrator, or other legal representative; (3) the business is continued by a receiver or trustee in bankruptcy; (4) the business is continued by an assignee for creditors; (5) one or more members withdraws from the firm or partnership; or (6) the corporate name is changed. A supplemental registration also must be filed each time an additional employee or agent is engaged to receive wagers.

In the event of a failure to register by a person required to pay the occupational tax, the Code imposes a penalty of \$50.<sup>66</sup> Any person who is liable for the occupational tax but does not

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<sup>59</sup> Sec. 4402(3).

<sup>60</sup> Sec. 4402(1) and (2).

<sup>61</sup> *Chickasaw Nation v. United States*, 534 U.S. 84 (2001) (holding that the Indian Gambling Regulatory Act does not exempt tribal governments from gambling related taxes in the same manner as States).

<sup>62</sup> Sec. 4411.

<sup>63</sup> Sec. 4902.

<sup>64</sup> Sec. 4412.

<sup>65</sup> Sec. 4412(c), Treas. Reg. sec. 44.4412-1(b)(2) and (b)(3); and Treas. Reg. secs. 44.4905-1 (relating to change of ownership) and 44.4905-2 (relating to change of address).

<sup>66</sup> Sec. 7272(a).

pay such tax shall, in addition to being liable for such tax, be fined not less than \$1,000 and not more than \$5,000.<sup>67</sup>

### C. Economic Development Incentives

#### 1. Accelerated depreciation for business property on Indian reservations (sec. 168)

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j)<sup>68</sup> are determined using the following recovery periods:

**Table 1.—Comparison of Applicable Recovery Periods**

MACRS	Indian Reservation Property
3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Residential real property (27.5 years)	27.5 years
Nonresidential real property (39 years)	22 years

“Qualified Indian reservation property” eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a

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<sup>67</sup> Sec. 7262.

<sup>68</sup> This provision was enacted by the Omnibus Reconciliation Act of 1993, Pub. L. No. 103-66, sec. 13321(a) (Aug. 10, 1993). The provision originally applied to property placed in service before January 1, 2004, but was extended to 2005, 2006, and 2008 as follows: Pub. L. No. 107-147, §613(b); Pub. L. No. 108-311, §316; and Pub. L. No. 109-432, Division A, §112(a). The definition of *former* Indian reservation, as pertaining to the State of Oklahoma, was modified by Pub. L. No. 105-34, §1604(c)(2) (Aug. 5, 1997).

person who is related to the taxpayer;<sup>69</sup> and (4) not property placed in service for purposes of conducting gaming activities.<sup>70</sup> Certain “qualified infrastructure property” may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).<sup>71</sup>

An “Indian reservation” means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(10) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating “former Indian reservations in Oklahoma” as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before January 1, 2008.

## **2. Indian employment tax credit (sec. 45A)**

In general, a credit against income tax liability is allowed to employers for the first \$20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees.<sup>72</sup> The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer’s current-year qualified wages and qualified employee health insurance costs (up to \$20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An “Indian reservation” is a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(1) of the Indian Child Welfare Act of 1978. For purposes of the preceding

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<sup>69</sup> For these purposes, related persons is defined in section 465(b)(3)(C).

<sup>70</sup> Sec. 168(j)(4)(A).

<sup>71</sup> Sec. 168(j)(4)(C).

<sup>72</sup> This section was first enacted by the Omnibus Reconciliation Act 1993, Pub. L. No. 103-66, sec. 13322(b) (Aug. 10, 1993).

sentence, section 3(d) is applied by treating “former Indian reservations in Oklahoma” as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of \$30,000 (which after adjustment for inflation is currently \$40,000).<sup>73</sup> In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer’s shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a five percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee’s services relate to gaming activities or are performed in a building housing such activities.

The Indian employment tax credit is not available for taxable years beginning after December 31, 2007.

### **3. Empowerment zones (secs. 1393(a)(4) and 1391(g)(3)(E))**

Empowerment zones generally provide tax incentives for businesses that locate within certain geographic areas designated by the Secretaries of the Department of Housing and Urban Development (“HUD”) and Agriculture. The targeted areas are those that have a condition of pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and geographic size limitations. Empowerment zone designations generally remain in effect through December 31, 2009. The tax incentives include the empowerment zone employment credit, increased expensing under section 179, enterprise zone facility bonds, rollover of gain from the sale of empowerment zone assets, and an increased exclusion of gain from the sale or trade of qualified small business stock.

There have been three rounds of empowerment zone designations. The Omnibus Budget Reconciliation Act of 1993 authorized the designation of nine empowerment zones (“Round I empowerment zones”) and 95 enterprise communities to provide tax incentives for businesses to locate within targeted areas designated by the Secretaries of HUD and Agriculture.<sup>74</sup> The Taxpayer Relief Act of 1997 (“1997 Act”) authorized the designation of two additional Round I urban empowerment zones, and 20 additional empowerment zones (“Round II empowerment zones”). The Community Renewal Tax Relief Act of 2000 authorized a total of nine new empowerment zones (“Round III empowerment zones”). Indian reservations were not permitted

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<sup>73</sup> See IRS Form 8845, Indian Employment Credit (Rev. December 2006).

<sup>74</sup> The empowerment zone and enterprise community rules are found in sections 1391-1397 of the Code.

to qualify for the Round I designations (sec. 1393(a)(4)).<sup>75</sup> However, Indian reservations could be nominated for Rounds II and III (sec. 1391(g)(3)(E) and 1391(h)(3)). Part of Jackson County and all of Bennett and Shannon Counties in South Dakota comprise the Oglala Sioux Tribe Empowerment Zone.<sup>76</sup>

#### **4. Renewal communities (secs. 1400E(a)(1)(B)(ii), 1400E(a)(5) and 1400E(c)(2)(C)(ii))**

The Community Renewal Tax Relief Act of 2000 authorized the designation of 40 “renewal communities” for which special tax incentives are available.<sup>77</sup> The tax incentives include the renewal community employment credit, increased expensing under section 179, a commercial revitalization deduction, and capital gain exclusion for renewal community assets.

On January 24, 2002, the Department of Housing and Urban Development (“HUD”) announced the 40 communities that were designated as renewal communities from areas nominated by States and local governments. Twenty-eight of the areas are located in urban areas; twelve of the areas are located in rural areas.<sup>78</sup> The designation of an area as a renewal community will terminate after December 31, 2009.<sup>79</sup>

Indian reservations are eligible for designation as a renewal community. Certain differences exist with respect to the nomination and designation process and area requirements for Indian reservations. An area can become a renewal community only after a process of nomination and designation. The general nomination process requires that one or more local

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<sup>75</sup> The Omnibus Budget Reconciliation Act of 1993, which created empowerment zones, separately provided tax incentives for investment on Indian reservations. See Pub. L. No. 103-66, sec. 13321 (accelerated depreciation for property on Indian reservations) and sec. 13322 (Indian employment credit) (Aug. 10, 1990).

<sup>76</sup> Internal Revenue Service, Publication 954, *Tax Incentives for Distressed Communities* (January 2004) at 4.

<sup>77</sup> Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554 (Dec. 21, 2000).

<sup>78</sup> The twenty-eight urban renewal communities are: Mobile, Alabama; Los Angeles, San Diego, and San Francisco, California; Atlanta, Georgia; Chicago, Illinois; New Orleans and Ouachita Parish, Louisiana; Lawrence and Lowell, Massachusetts; Detroit and Flint, Michigan; Camden and Newark, New Jersey; Buffalo-Lackawanna, Niagara Falls, Rochester, and Schenectady, New York; Hamilton and Youngstown, Ohio; Philadelphia, Pennsylvania; Charleston, South Carolina; Chattanooga and Memphis, Tennessee; Corpus Christi, Texas; Tacoma and Yakima, Washington; and Milwaukee, Wisconsin.

The twelve rural renewal communities are: Greene-Sumter, Alabama; Southern Alabama; Orange Cove and Parlier, California; Eastern Kentucky; Central and Northern Louisiana; West-Central Mississippi; Turtle Mountain Band of Chippewa, North Dakota; Jamestown, New York; El Paso County, Texas; and Burlington, Vermont.

<sup>79</sup> The designation would terminate earlier than December 31, 2009, if (1) an earlier termination date is so designated by the State or local government, or (2) the Secretary of HUD revokes the designation as of an earlier date.

governments and the State in which the area is located nominate the area for designation as a renewal community. An area within an Indian reservation may be nominated to be a renewal community by the reservation governing body without the participation of other local or State governments. The general designation process requires that the Secretary of HUD consult with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Office of Management and Budget, and the Administrator of the Small Business Administration prior to designating an area as a renewal community. The designation process for an area located within an Indian reservation requires the Secretary of Housing and Urban Development to consult with the organizations mentioned above, and also to consult with the Secretary of the Interior. The generally applicable area requirement provides a minimum and maximum population range. The area requirement for a renewal community entirely within an Indian reservation does not require a minimum and maximum population range.

**D. Exclusion From Income and Employment Taxation of Income Derived by Indians From Exercise of Fishing Rights (sec. 7873)**

Income derived from treaty recognized fishing rights-related activity by a member of an Indian tribe or a qualified Indian entity is excluded from income and employment taxes.<sup>80</sup>

**E. Exemption from Federal Unemployment Tax for Employment by Indian Tribes (secs. 3306(c)(7), (u), and 3309(d))**

Under the Federal Unemployment Tax Act (“FUTA”), employers must pay a tax equal to 6.2 percent<sup>81</sup> on total wages paid with respect to covered employment. Indian tribes, like State or local governments, may elect to pay FUTA taxes only when a former employee claims unemployment benefits. Only then does such electing employer have FUTA tax liability. Generally, the FUTA liability due equals the amount of such benefits claimed. Thus, for FUTA tax purposes, Indian tribes are treated the same as State and local governments. For purposes of the election, Indian tribe is defined as including any subdivision, subsidiary, or business enterprise wholly owned by the Indian tribe. An Indian tribe may make a separate election for itself and each subdivision, subsidiary, and business enterprise wholly owned by the tribe.<sup>82</sup>

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<sup>80</sup> Sec. 7873. This provision was enacted by the Technical and Miscellaneous Revenue Acts of 1988, Pub. L. No. 100-647, sec. 3041(a) (Nov. 10, 1988).

<sup>81</sup> The rate of tax is six percent in 2009 and thereafter.

<sup>82</sup> This exemption was enacted by the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, sec. 166(a)(1)-(2) (Dec. 21, 2000).

## **F. Charitable Contribution Deduction for Certain Expenses in Support of Native Alaskan Subsistence Whaling (sec. 170(n))**

In general, no charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization contributions to which are deductible may constitute a deductible contribution.<sup>83</sup>

Effective for contributions made after December 31, 2004, a special rule permits a charitable deduction not exceeding \$10,000 per taxable year for certain expenses incurred in carrying out sanctioned whaling activities.<sup>84</sup> The deduction is available only to an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities. The deduction is available for reasonable and necessary expenses paid by the taxpayer during the taxable year for: (1) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities; (2) the supplying of food for the crew and other provisions for carrying out such activities; and (3) the storage and distribution of the catch from such activities.<sup>85</sup>

For purposes of this special rule, the term “sanctioned whaling activities” means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.<sup>86</sup>

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<sup>83</sup> Treas. Reg. sec. 1.170A-1(g).

<sup>84</sup> Sec. 170(n). This provision was enacted by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 882(b) (Oct. 22, 2004).

<sup>85</sup> Sec. 170(n)(2).

<sup>86</sup> Sec. 170(n)(3).

### III. BACKGROUND STATISTICS ON NATIVE AMERICANS

#### A. Overview

Native Americans are a historically economically disadvantaged group in the United States. The average unemployment rate among Native Americans is nearly 50 percent.<sup>87</sup> Today, the economic situation of Native Americans is worse than any other minority group. In 2006, the median income of Native American households was \$31,600, 41 percent lower than the median income of the population, \$44,700.

Although Native Americans make up less than one percent of the U.S. population, they make up a much larger percentage of the population in States in the Southwest, Northern Plains and Alaska. Native Americans are unique as an ethnic group because they are eligible to live on reservations – tracts of lands set aside by the United States government for Native Americans to live and maintain their distinct heritage. Thirty percent of Native Americans live on reservations.<sup>88</sup>

#### B. Proportion of Native Americans in the U.S. Population

Native Americans and Alaskan Natives make up 2.1 million people in the United States, less than one percent of the total population. However, another 1.9 million Americans affirm they are both Native American and another race, making a total of four million Americans (1.4 percent) all or part Native American. Excluding Pacific Islanders, Native Americans are the smallest minority group recorded by the U.S. Census. For purposes of this analysis, the group "Native Americans" only includes people who self-identified as Native American or Alaskan Native and no other race.

Most Native Americans are affiliated with one or more specific tribes; Cherokee (281,069), Navajo (269,202), and Sioux (108,272) are the most populous tribes in the United States.<sup>89</sup> There are also very small tribes with fewer than 100 members such as Croatan, which had 77 members as of the 2004 census estimations.<sup>90</sup> Figure 1 aggregates all tribes that make up less than 4 percent of the total Native American population into one large group, including all Alaskan Natives such as Eskimo, Aleut and Inuit, who are all a part of distinct tribes. Tribal affiliations are important because Federal and tribal benefits are often linked to formal tribal

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<sup>87</sup> Department of the Interior, Bureau of Indian Affairs, Office of Tribal Services *American Indian Population and Labor Force Report*. Washington: 2003 Available: <http://www.doi.gov/bia/docs/laborforce/2003LaborForceReportFinalAll.pdf> [14 July 2008].

<sup>88</sup> U.S. Bureau of the Census: *The American Community—American Indians and Alaska Natives: 2004*. Detailed Tables, B02001 and B02010. Washington: May, 2007.

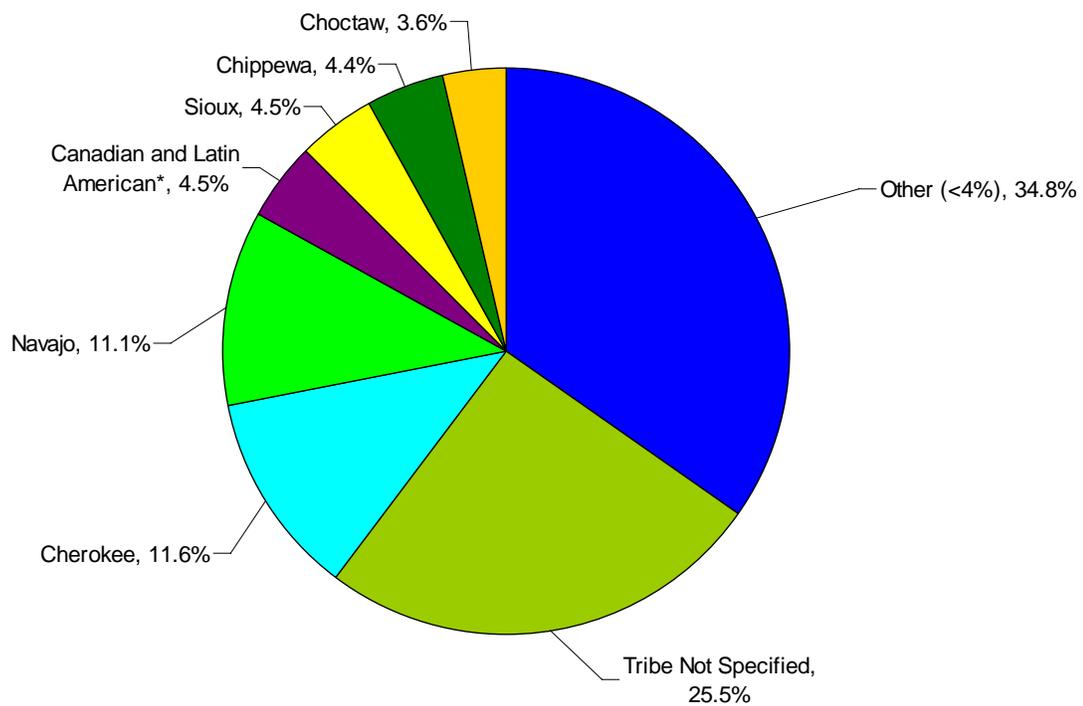
<sup>89</sup> U.S. Bureau of the Census. *American Indian and Alaska Native Population by Tribe*. Washington: 2000.

<sup>90</sup> U.S. Bureau of the Census. *American Indian and Alaska Native Tribes in the United States*. Table 37, Washington: 2000.

membership; however, 25.5 percent of Native Americans did not specify their tribe. Each individual tribal government makes decisions on tribal membership.

Figure 1, below, displays the percentage of Native Americans by tribal affiliation. While Cherokee and Navajo are the two largest single tribes, the vast majority of Native Americans are in much smaller tribes or are unaffiliated with any tribe.

**Figure 1.—Percentage Distribution by Tribal Affiliation**



\*Canadian and Latin American indicate people of indigenous ancestry to those regions, not regions in the United States.

Source: U.S. Bureau of the Census. *American Indian and Alaska Native Population by Tribe*. Washington: 2000.

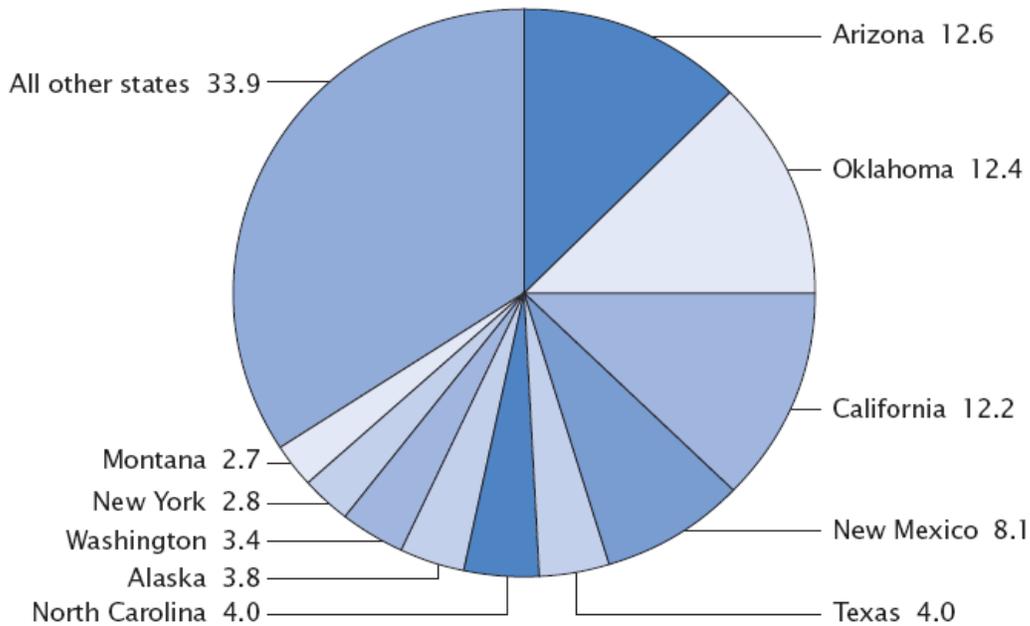
### C. Geographic Distribution of Native Americans in the United States

Figure 2 shows the State of residence of the total U.S. Native American population, while Figure 3 shows the Native American population rate by State. Over 12 percent of all Native Americans live in California; however, the State is so populous that Native Americans comprise less than one percent of the total State population. Figure 2 shows that only 3.8 percent of the country's Native Americans live in Alaska, but Figure 3 shows that Native Americans comprise nearly 13 percent of the State's population.

Figure 2 shows that more than one-third of all Native Americans reside in three States: Arizona, California and Oklahoma. The Native American population is most concentrated in the Western States, comprising greater than five percent of the population in Alaska, Oklahoma, Arizona, New Mexico, Montana and North Dakota.

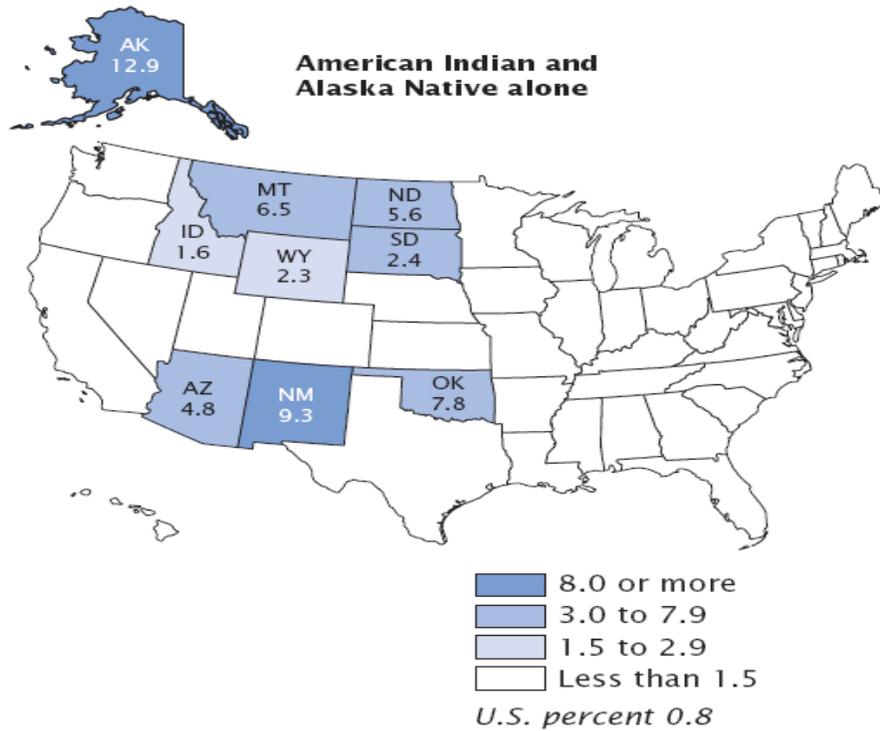
**Figure 2.—Distribution of Native Americans and Alaskan Natives by State of Residence**

**American Indian and Alaska Native Alone**



Source: U.S. Bureau of the Census. *The American Community—American Indians and Alaska Natives: 2004*. Detailed Table, S0201. Washington: May, 2007.

**Figure 3.—Native American Population Percentages for Selected States**



Source: U.S. Bureau of the Census: *The American Community—American Indians and Alaska Natives: 2004*. Detailed Tables, B02001 and B02010. Washington: May, 2007.

Native Americans are considered the most rural of minority populations. While many other minority populations are heavily clustered in urban areas and States with high percentages of the populations located in urban areas, Native Americans mostly live in rural regions in the Southwest, Northern Plains and Alaska. Approximately 30 percent of all Native Americans live on reservations, land set aside by the United States government for exclusively Native American development.<sup>91</sup> The majority of Native Americans (70 percent) do not live on reservations. The proportion of Native Americans living on reservations varies greatly by state. In Oklahoma, nearly half of all Native Americans live on a reservation, while in Arizona, fewer than three percent of all Native Americans live on a reservation.<sup>92</sup> Figure 3, above, shows the Native American population rates for selected States.

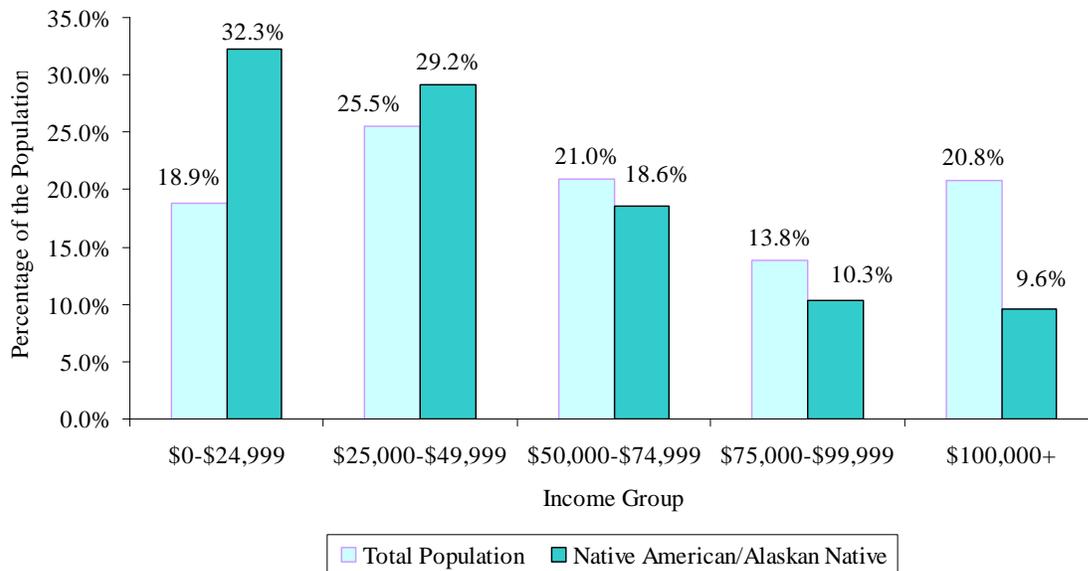
<sup>91</sup> U.S. Bureau of the Census. *The American Community—American Indians and Alaska Natives: 2004*. Detailed Tables, B02001 and B02010. Washington: May, 2007.

<sup>92</sup> U.S. Bureau of the Census. *Population Living on Selected Reservations and Trust Lands*. Table 38, Washington: 2000.

### D. Economic Status of Native American Peoples

According to the United States census, the median income of a Native American household in 2006 was \$31,600, 42 percent lower than \$44,996, the median income in South Dakota and 23 percent lower than \$38,859, the median income of Oklahoma, two States with relatively high percentages of Native Americans.<sup>93</sup> The U.S. median income of \$44,700 is 41 percent higher than the median for Native Americans. Figure 4, below, shows the income distribution of Native American households relative to the total population. The greatest differences in the income distribution are at the extremes. Native Americans are almost twice as likely as the rest of the population to earn under \$25,000 per year (32.3 percent versus 18.9 percent) and less than half as likely (9.6 percent versus 20.8 percent) to earn more than \$100,000 per year.

**Figure 4.—Income Distribution of Native Americans and Non Native Americans**



Source: U.S. Bureau of the Census. *Selected Characteristics of Racial Groups and Hispanic/Latino Population*: Table 36. Washington: 2000.

<sup>93</sup> U.S. Bureau of the Census. *Two-Year-Average Median Household Income by State: 2004-2006*. Washington: 2006. Available: <http://www.census.gov/hhes/www/income/income06/statemhi2.html> [16 July 2008].

Much of the differential in income may be driven by the extremely high rates of unemployment on reservations and among Native Americans in general. In 2003, 49 percent of the population eligible to work was unemployed; of the 51 percent of Native Americans who were employed, 32 percent had annual earnings below the poverty line. Sixty-six percent of Native Americans were either unemployed, or employed with earnings that left them below the poverty line. Table 2 provides detailed information on Native American unemployment and poverty statistics by state.

**Table 2.—Native American Unemployment and Employed But Below Poverty Line,  
by State in 2003**

<b>By State</b>	<b>Tribal Enrollment</b>	<b>Unemployment<sup>1</sup> Rate</b>	<b>Employed With Earnings Below Poverty Line</b>
Alaska	136,315	43	41
Alabama	2,264	26	42
Arizona	264,984	59	29
California	55,158	40	36
Colorado	3,467	7	19
Connecticut	2,334	25	NR
Florida	3,383	48	NR
Idaho	12,102	73	31
Indiana	NR	28	33
Iowa	1,309	60	0
Kansas	9,562	79	5
Louisiana	3,090	76	21
Massachusetts	1,065	44	24
Maine	261	56	38
Michigan	53,879	59	20
Minnesota	51,267	37	41
Mississippi	9,239	25	20
Montana	65,299	65	33
Nebraska	16,431	52	45
Nevada	12,547	50	44
New Mexico	170,162	49	20
New York	19,618	65	59
North Carolina	13,128	36	NR
North Dakota	63,263	66	30
Oklahoma	675,021	30	33
Oregon	22,285	27	22
Rhode Island	2,748	NR	NR
South Carolina	2,478	45	17
South Dakota	105,068	84	49
Texas	2,771	44	6
Utah	15,836	64	31
Washington	54,128	62	39
Wisconsin	54,961	51	38
Wyoming	11,227	73	12
U.S. Total	1,923,650	49	32

Total Eligible Workers = All people under and over age 65 who can work or are able to sustain gainful employment.  
Poverty line based on the number of workers and total members of the household.

NR Totals Not Reported

Source: Department of the Interior, Bureau of Indian Affairs, Office of Tribal Services American Indian Population and Labor Force Report. Washington: 2003 Available:

<http://www.doi.gov/bia/docs/laborforce/2003LaborForceReportFinalAll.pdf> [14 July 2008].

<sup>1</sup> Unemployment = Number Employed/Total Eligible Work Force.

High unemployment, paired with low average income, has yielded a 25-percent poverty rate in Native American populations compared with-nine-percent poverty rate in the white population.<sup>94</sup> The differential is greater for children, with 31 percent of Native American children living in households in poverty, relative to 11 percent of children in impoverished households in the rest of the population. In the over-65 population, 20 percent of Native Americans are in poverty compared to only seven percent of the white, over-65 population in poverty. Table 2 shows that the unemployment rate among Native Americans is high – over 20 percent in every State (except Colorado). In South Dakota, where more than 100,000 Native Americans reside, the unemployment rate is 84 percent, meaning only one in six eligible workers has a job.

Occupational choice among employed Native Americans is similar to that of the rest of the population as shown in Table 3, below. There are small differences with slightly more Native Americans performing service jobs and doing construction, and fewer Native Americans in management and professional occupations.

**Table 3.–Occupations Among Native Americans**

<b>Employed Civilian Population, 16 Years Old and Over, Total</b>	<b>Total Population</b>	<b>Native American</b>
Management, professional, and related occupations	34.1	26.1
Service occupations	16.3	21.3
Sales and office occupations	25.9	23.0
Farming, fishing, and forestry occupations	0.7	1.2
Construction, extraction, and maintenance occupations	10.0	13.5
Production, transportation, and material moving occupations	13.0	15.0

Source: U.S. Bureau of the Census: *The American Community—American Indians and Alaska Natives: 2004*. Detailed Table, S0201. Washington: May, 2007.

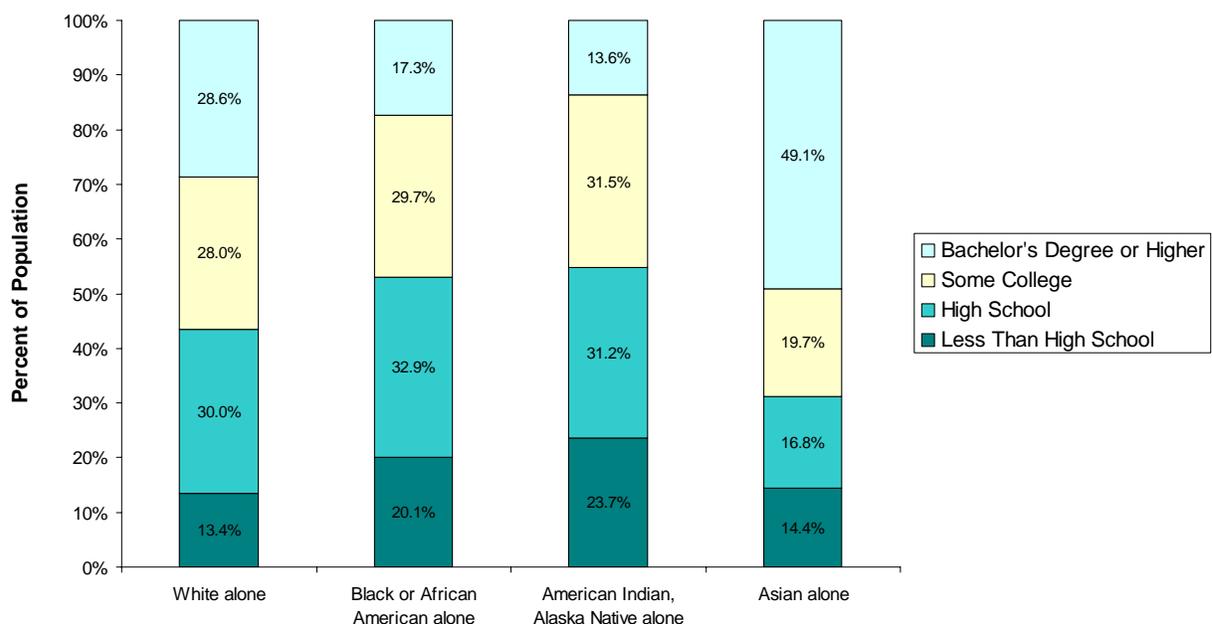
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<sup>94</sup> U.S. Bureau of the Census. *The American Community—American Indians and Alaska Natives: 2004*. Detailed Table, S0201. Washington: May, 2007.

### E. Educational Attainment, Household Structure and Health Status of Native Americans

Educational attainment is lower for Native Americans than it is for all other groups. Fewer than 15 percent of Native Americans receive a bachelor's degree or higher, less than half the rate of the total population. In addition, 24 percent of all Native Americans did not complete high school or high school equivalency compared to 13 percent of whites, 20 percent of blacks and 14 percent of Asians. Figure 5 shows the breakdown of educational attainment by race in 2005. Native Americans educational attainment was lower than the educational attainment of blacks, whites or Asians, with fewer than 45 percent receiving some post-high school education and fewer than 14 percent graduating from college.

**Figure 5.—Top Educational Achievement by Race**

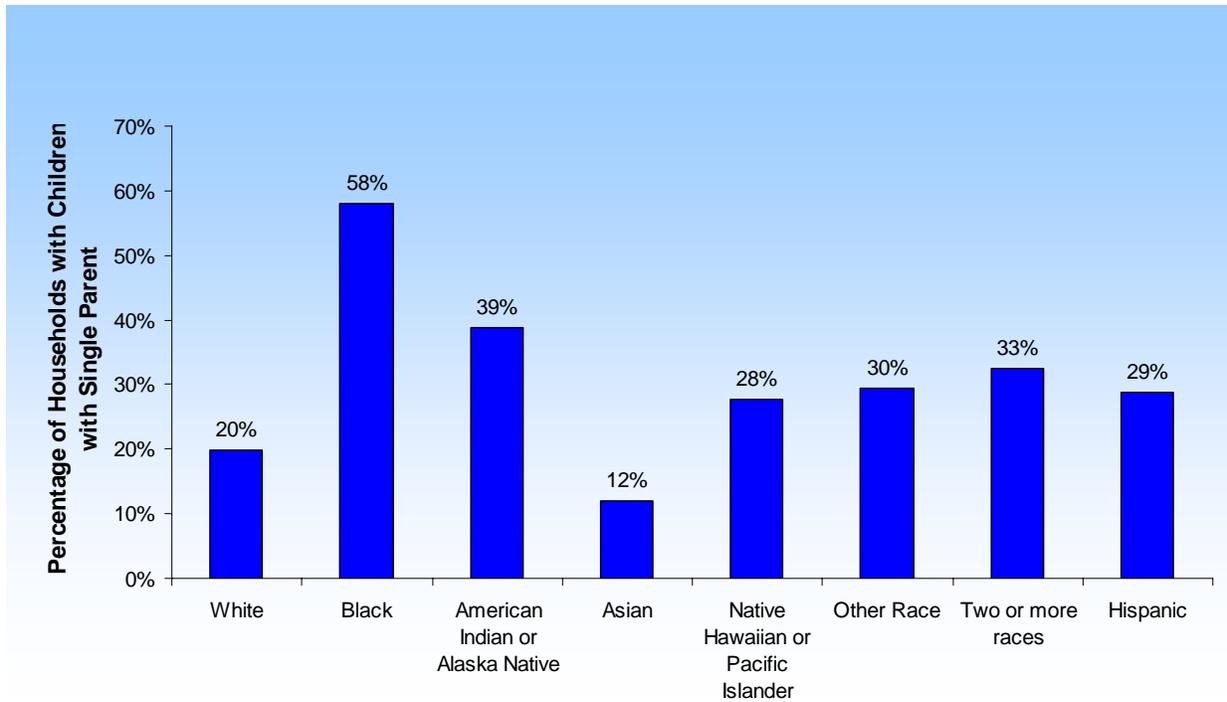


Source: U.S. Bureau of the Census. *Selected Characteristics of Racial Groups and Hispanic/Latino Population: Table 36.* Washington: 2000.

In 2000, 39 percent of Native American households were single-parent households, relative to 20 percent of white households, 12 percent of Asian households and 58 percent of black households. In 4.1 percent of Native American homes, grandparents rather than parents were the primary caretakers of children in the households, relative to 1.4 percent of homes in the total population. In 1995, 20 percent of tribal residents did not have complete plumbing. This

was reduced to 11.7 percent by 2000, but was still more than ten-fold greater than the national rate of 1.2 percent.<sup>95</sup>

**Figure 6.—Own Children in Single Parent Households by Race in 2000**



Source: U.S. Census Bureau, 2000 Census Summary File 1 (Tables P28A-P28H).

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<sup>95</sup> National Congress of American Indians. Testimony on the Administration's Fiscal Year 2008 Budget Request For Indian Programs. Senate Committee on Indian Affairs, February 15, 2007. Available: [http://www.ncai.org/nci/resource/data/docs/legislative/NCAI\\_Budget\\_Testimony\\_FY08\\_FINAL.pdf](http://www.ncai.org/nci/resource/data/docs/legislative/NCAI_Budget_Testimony_FY08_FINAL.pdf) [15 July 2008].

## F. Indian Health Service and Health Status of Native Americans

All people who can reasonably claim Native American heritage are entitled to care through the Indian Health Service. Generally, this is limited to Native Americans living on or near a reservation. However, (“HIS”) supply is severely limited by the budget. Most recently, the average funding of an IHS site was found to be 40 percent less than an equivalent average health insurance plan.<sup>96</sup> Among all Native Americans, 35 percent are uninsured.<sup>97</sup> Fifty-five percent of Native Americans rely on the IHS’s 49 hospitals and 600 other health facilities for care.<sup>98</sup>

**Table 3.–Major Disease Burden in Native Americans Populations**

<b>Disease</b>	<b>Likelihood of Disease Relative to the Rest of the Population</b>
Alcoholism	6.38
Tuberculosis	4.00
Suicide	2.91
Infant Mortality	1.25

Source: U.S. Department of Health and Human Services: Indian Health Service, *Trends in Indian Health in 2000-2001*

The life expectancy of a Native American is 2.4 years less than the U.S. average life expectancy. Certain diseases have far greater prevalence in the Native American community than in the rest of the community. Alcoholism and tuberculosis are the most well known to affect Native Americans disproportionately and are also the most debilitating.

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<sup>96</sup> U.S. Department of Health and Human Services, Indian Health Service. *Personal Health Services Funding Disparities*. Washington: January 2007. Available: <http://info.ihs.gov/Files/FundingDisparity-Jan2007.doc> [15 July 2008]

<sup>97</sup> The Kaiser Family Foundation. *American Indians and Alaska Natives: Health Coverage and Access to Care*. February 2004. <http://www.kff.org/minorityhealth/upload/American-Indians-and-Alaska-Natives-Health-Coverage-Access-to-Care.pdf> [16 July 2008].

<sup>98</sup> U.S. Department of Health and Human Services, Indian Health Service. *Facts On Indian Health Disparities*. Washington: January, 2006. <http://info.ihs.gov/Files/DisparitiesFacts-Jan2006.pdf> [16 July 2008].