

TESTIMONY OF THE NATIONAL CONGRESS OF AMERICAN INDIANS
ON
THE FEDERAL TAX TREATMENT OF HEALTH CARE BENEFITS
PROVIDED BY TRIBAL GOVERNMENTS TO THEIR CITIZENS

UNITED STATES SENATE COMMITTEE ON INDIAN AFFAIRS
SEPTEMBER 17, 2009

On behalf of the National Congress of American Indians, thank you for the opportunity to provide our views on an issue of critical importance to tribal governments and tribal citizens throughout the United States. It is often said that there are no new issues in Indian country – that the same old issues re-circulate again and again. However, thanks to enterprising auditors at the Internal Revenue Service, this has been proven untrue. The IRS is now engaged in a broad and unprecedented effort to tax the basic human services that Indian tribal governments provide to their members. This is a direct affront to tribal sovereignty, a violation of the federal trust responsibility, and at best is utterly bad federal policy. We cannot understand why the federal government would choose to create a disincentive for Indian tribal governments to provide basic human services to their members.

One of our major concerns is that there has been little or no policy guidance from the Treasury Department, and instead IRS auditors are creating policy through the rote application of a tax code that was never intended to reflect the fundamental federal-tribal relationship embodied in the U.S. Constitution. Moreover, we are concerned that the IRS actions are highly discriminatory in impact if not in intent. The IRS is subjecting tribal governments to audits on issues that have never been raised when substantially similar benefits have been provided by other government entities. The IRS has initiated 139 examinations during the past two years that focused specifically on the use of tribal government revenues used to provide governmental services to tribal citizens.¹

This Committee has noted that the IRS is targeting health care benefits and services provided by tribal governments. This is our chief concern. The federal government has treaty and trust responsibilities to provide health care to American Indians and Alaska Natives. The Indian Health Service is the federal agency responsible for providing this care, yet the IHS is funded at only 60% of need. Most tribal communities cannot readily access health care services and, even when services are available, they are often subject to decades-old, outdated practices and services. As detailed in the statement submitted by the National Indian Health Board, across every indicator, American Indian and Alaska Natives face massive disparities in health.

In response to the need for adequate health care, Indian tribal governments throughout the United States have implemented a wide variety of supplemental measures, including the following:

- Direct health care in the form of tribally-funded health care clinics;
- Tribal subsidies for programs that the tribe operates under a contract or compact with the Indian Health Service (IHS);

¹ IRS Letter to The Honorable Senator Charles Grassley, Ranking Member of the Finance Committee, June 28, 2009.

- Tribal health care reimbursement programs or plans that pay for the cost of care not covered by IHS (because of funding shortfalls) or other sources; and
- Self-insured tribal health care plans and group health insurance policies that cover tribal members and their dependents.

Yet, it is our understanding that in the scenarios described above (all of which involve dedication of tribal government revenues to supplement the inadequate IHS system), the IRS is attempting to require the tribe to issue 1099 forms to each tribal member. This makes no sense from a policy perspective as it reduces the net amount of health care expenditures that tribal governments will be able to fund. It also compounds the violations of federal trust and treaty responsibilities, as tribal members would be required pay federal taxes on health benefits that should have been provided by the federal government in the first place.

Moreover, we understand that the IRS is not targeting only health care services. The IRS is also proposing that tribe withhold or report on basic educational services, job training, meals for elders, housing assistance, the provision of safe drinking water, and waste disposal services. All of these are government services that are commonly provided by other governments. We have also heard from our members that IRS personnel have instructed a pueblo to issue 1099 forms for the meals provided at a traditional feast day. All of these raise issues raise very serious concerns for tribal leaders.

We would urge Congress to engage in a two-track effort to address these problems. First, Congress should consider legislation that would specifically amend the IRS to exempt health care services provided by Indian tribes. Second, Congress needs to exercise oversight over the Treasury Department and the IRS to ensure that adequate policy guidance is provided.

Legislation Needed

NCAI and many tribes have proposed a legislative fix that would clarify that health care benefits provided by tribal governments are excludable from gross income. This legislative clarification should be included in the national “Health Care Reform” bill. (NCAI is proposing several other health care amendments to protect IHS and tribal health care systems.) We are particularly grateful to Chairman Baucus of the Senate Finance Committee, Chairman Rangel of the Ways and Means Committee, along with Representatives Becerra and Nunes and many others, for their support and encouragement of this proposal.

Although NCAI would prefer to exempt all tribally provided social welfare benefits, our supporters in Congress are indicating that it will be difficult to include all general welfare issues as part of a health care bill. Instead, they are asking that we consider excluding only tribal health care benefits as a part of this legislation, and we use that to build momentum for a broader exclusion of all tribally provided social welfare benefits. NCAI will continue to push for a broad exclusion, but at this point NCAI is supporting a narrower exclusion of tribal health care benefits as a first step.

There is a concern that if we address health care in the legislation, the IRS will be even more likely to challenge other welfare programs provided by tribal governments. To guard against this

we are urging Congress to include “no-inference” language in both the statute and committee reports, to make sure that the legislative history is clear that there are many tribal government programs that are not subject to tax, and to continue oversight with Treasury and IRS officials at the highest levels to curb the overly aggressive approach to tribal government social welfare benefits.

Oversight Needed on Application of “General Welfare” Doctrine

Indian tribal governments have a unique status in our federal system under the U.S. Constitution and numerous federal laws, treaties and federal court decisions. They have a governmental structure, and have the power and responsibility to enact civil and criminal laws regulating the conduct and affairs of their members and reservations. They operate and fund courts of law, police forces, and fire departments. They provide a broad range of governmental services to their citizens, including education, transportation, public utilities, health, economic assistance, and domestic and social programs. Like states and local governments, tribal revenues and property are not treated as taxable income – but as the governmental revenues of a distinct sovereign. Tribes are generally treated in the same manner as states under the IRS Code, 26 USC Sec. 7871, the Indian Tribal Governmental Tax Status Act of 1982. In contrast, individual tribal members, whether they live on or off-reservation, are generally subject to federal taxes.

Internal Revenue Code Section 61 provides that, gross income includes all income from whatever source derived unless excluded by law. The IRS and the federal courts have consistently held that payments made under legislatively provided social benefit programs for the promotion of general welfare are not includable in the recipient's gross income.² Revenue Ruling 76-131, 1976-1 C.B. 16 explicitly lists health as a need that promotes the general welfare. The problem is that the IRS seems to have narrowed its interpretation of the general welfare doctrine in the context of tribal governments to require that the recipient demonstrate financial need, and not simply that the benefit contribute to the welfare of the community.

This is where we sharply disagree with the discriminatory application of the general welfare doctrine by the IRS. First, the general welfare doctrine originated in a 1938 decision by the IRS to exempt the Social Security system, which is not a means tested program.³ Second, in Revenue Ruling 70-341, 1971-2 C.B. 31, the IRS ruled that government provided health care benefits for the elderly, commonly known as Medicare benefits, are nontaxable to all recipients, not only to those in financial need. Third, federal and state governments commonly provide vaccinations and basic health tests to all citizens free off charge. Fourth, the Federal government has a longstanding policy of providing tax-free medical care to Indians. To effect this policy, federal statutes have been enacted stating that a major "goal of the United States is to provide the quantity and quality of health services which will permit the health status of Indians to be raised

² See, e.g., Rev. Rul. 57-102, 1957-1 C.B. 26 (payments to the blind); Private Letter Ruling 200845025 (November 7, 2008) (ruling that payments made by an Indian tribe to elderly tribal members who were displaced by a flood were general welfare payments); *Bailey v. Commissioner*, 88 T.C. 1293 (1987) (considering whether grants to restore a building façade were excludable from income as general welfare payments).

³ See I.T. 3194, C.B. 1938-1 114, which concluded that lump sum payments made to individuals as Social Security benefits not subject to federal income tax in the hands of the recipients.

to the highest possible level" and providing specific authorization for the Indian Health Service, a federal agency that administers funds provided by Congress for the promotion of Indian health care services.⁴

In addition, the IRS has never attempted to subject to income tax the value of myriad non-medical federal, state and local government services that are provided to all citizens regardless of income. It is common for state and local governments to provide refuse and trash collection, recycling collection, snow removal, and hazardous waste disposal to all citizens. For example, the City of San Diego has provided free trash collection for the last 96 years without a challenge by the IRS. Cities and local governments also provide free access to benefits with clear value to individuals, such as public libraries, public education, pest eradication programs, museums and public parks, and public concerts and events. Free government services range from National Public Radio and Television, to the local pancake breakfast provided by a Parent Teacher Association.

As indicated by past IRS rulings and administrative practice, the general welfare doctrine is clearly much broader than simply those programs provided to low-income individuals. In practice, the general welfare doctrine has exempted all legislatively provided public benefits that do not inure simply to the individual, but improve the entire community.

Health care is a classic example of a government service that does not benefit only an individual. In the treatment and prevention of infectious diseases it is essential that all members of a community receive treatment in order to protect the entire community. Beyond this, a healthy workforce is necessary for the economy, and healthy children are a prerequisite for successful education. Moreover, medical researchers are proving that more and more medical conditions are in effect "contagious" – obesity, smoking, diabetes, drugs and alcohol – all of these are examples where an individual's social interactions with the rest of the community have a significant effect on the entire community's health. An Indian tribe, just like any government, has an enormous interest in ensuring that its citizens share in the benefits of excellent community health.

We can think of no legitimate reason why the IRS would choose to discriminate against tribal government services, but it appears to be that the IRS is confused because of the source of tribal revenues. Although Indian tribal governments are tax collecting entities and tribes often collect sales and excise taxes, unlike States, tribes typically lack an adequate tax base on the reservations, and have traditionally relied on revenue from their own natural resources, federal appropriations, and tribal business enterprises to fund their governments and government programs.

Indian gaming has grown to be the most significant source of revenue for tribal governments, in much the same way that state lotteries and other forms of state gaming have grown significantly in recent years. The source of tribal revenues provides no rationale for discriminating against tribal general welfare programs. Congress's intent that general welfare benefits for tribal members should not be treated as income is made clear in the Indian Gaming Regulatory Act,

⁴ 25 U.S.C. §1601(b) and 25 U.S.C. §13.

where Congress distinguished between revenues used to provide for the general welfare and per capita payments.

25 USC 2710 provides that:

- (B) net revenues from any tribal gaming are not to be used for purposes other than--
 - (i) to fund tribal government operations or programs;
 - (ii) to provide for the general welfare of the Indian tribe and its members;
 - (iii) to promote tribal economic development;
 - (iv) to donate to charitable organizations; or
 - (v) to help fund operations of local government agencies;

- (3) Net revenues from any class II gaming activities conducted or licensed by any Indian tribe may be used to make per capita payments to members of the Indian tribe only if...
 - (D) the per capita payments are subject to Federal taxation and tribes notify members of such tax liability when payments are made.

In fact, the in the only clear guidance provided to Indian tribes on the appropriate uses of gaming revenue under the Act, tribal governments have been encouraged to use gaming revenue to provide for the health care needs of their members, including through universal coverage programs.⁵

Conclusion

NCAI urges Congress to immediately pass legislation that would specifically exclude tribal health benefits from income for federal tax purposes. Even with this legislative fix, we anticipate that Indian tribes will be subject to vexatious IRS audits on other social welfare programs that will create uncertainty and delay tribal progress for years to come. Oversight and engagement with the Treasury Department is needed to ensure that proper policy guidance is provided to the IRS to ensure that Indian tribal governments are treated equitably. We thank you for your diligent efforts on behalf of Indian country on these and many other issues.

⁵ See NIGC Bulletin No. 05-1 (Subject: Use of Net Gaming Revenue) (January 18, 2005) (available at <http://www.nigc.gov> under the "Reading Room" tab and "Bulletins" sub-tab).