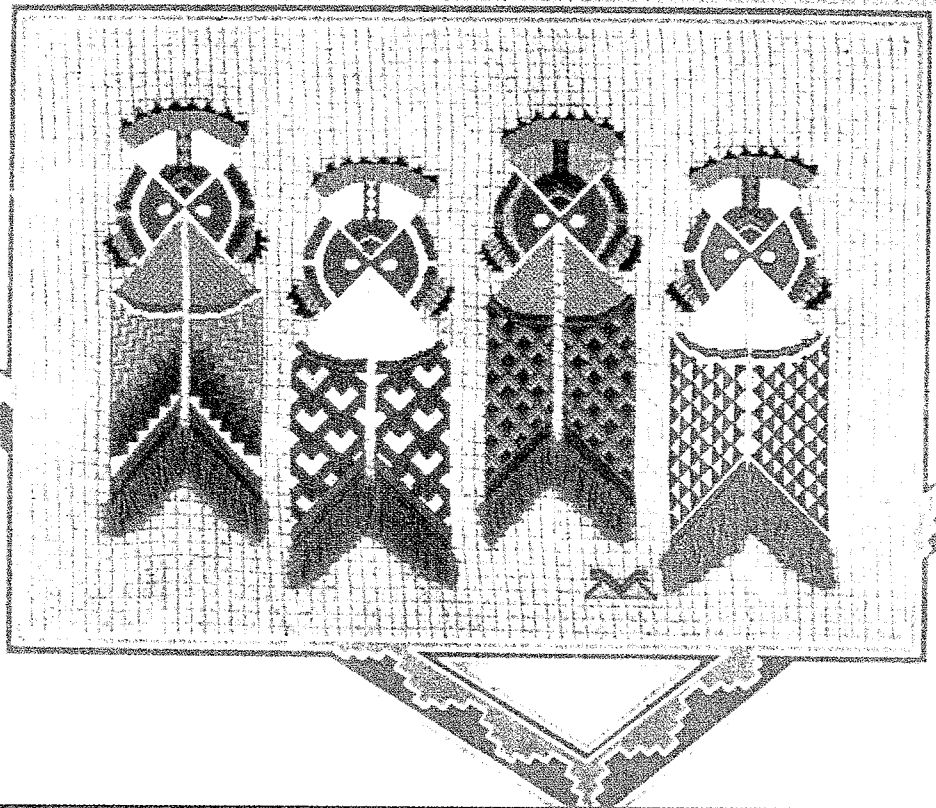


# GIVING WITH HONOR



**A LEGAL REFERENCE ON  
CHARITABLE ACTIVITIES OF  
AMERICAN INDIAN TRIBES**

 **COUNCIL ON FOUNDATIONS  
NATIVE AMERICANS IN PHILANTHROPY**



# THE TRADITIONS OF GIVING

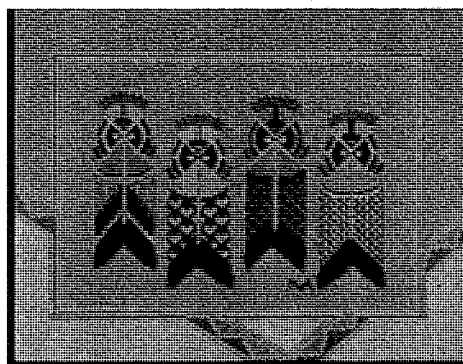
BY INGRID WASHINAWATOK

**G**iving within the Indian community is nothing new. Actually it is as old as the beginning of time. The concept of giving came with the Original Instructions and in the Creation Stories when Indians were first placed upon this earth. The instructions were given that, upon arising each day, thanks are to be given for the new day and when anything is to be taken from the bounty of the earth, an offering is to be made, whether tobacco or corn pollen, in prayer or in song. It must be done so that the circle of life continues: Hunters before the hunt, whalers before the voyage, trappers before the long journey; in the spring during the planting and again at the harvest, to the maple trees during sugaring and to the waters during ricing. That is the agreement to this day of our ability to live on this earth.

When the time came for the division of the bounty, the elders and the medicine people were the first recipients and the rest was divided accordingly, so that all members of the community had what they would need.

In the Indian communities of North America the idea was not to amass wealth by material goods; it made no sense to have more than you need. If, for whatever reason, one had many things, more than their particular family needed, it was given away. Today, in contemporary Indian society, the concept still holds. At large gatherings like powwows, for example, a significant event in a person's life is marked and a give-away is held.

Today, on the brink of the 21st century, the tradition of giving in the Indian communities is still a valued ethic. From offerings to the black ash trees and sweetgrass so baskets can be made for family income, to scholarships to honor the memory of a loved one, to the distribution of meat or fish by the young men's first kill or catch, to community powwows to send an athlete to national or international competition, the realization of the circle of life takes on an even stronger constitution in this day and age. The cyclical concept of life is not a quaint notion nor mythological terminology. It is a holistic concept that encompasses all of creation, one from which human beings cannot separate themselves. Whatever befalls the earth befalls the people of the earth, whatever the people do to the earth, they do to themselves. When you give (make the offering), you are able to receive. That is the agreement, those are the instructions, to this day.



# **GIVING WITH HONOR**

## **A LEGAL REFERENCE ON CHARITABLE ACTIVITIES OF AMERICAN INDIAN TRIBES**

**Council on Foundations  
Native Americans in Philanthropy**

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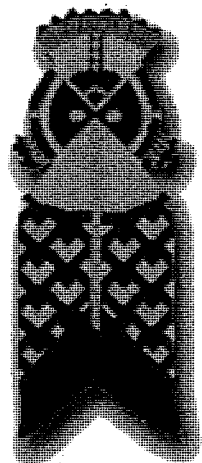
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## INTRODUCTION



# CHARITABLE GIVING AND TRADITIONS IN NATIVE AMERICAN COMMUNITIES

**C**haritable giving is a time-honored tradition throughout the United States. Giving is so enmeshed within national life that most Americans view charitable donations as a routine part of life. Many cultures, including Native American cultures, have especially strong traditions of giving and receiving gifts.

Charitable donations built, and continue to support, many of this nation's schools, youth clubs and other community institutions. They make scholarships available to people who have the talent and will, but lack the resources, to continue their education. Such institutions fund medical, scientific and public policy research projects, which, in turn, have brought such advances as the vaccine for polio, the cure for yellow fever, the 911 emergency response network and hospices. And they ensure that food, clothing and shelter are available to support needy families, the homeless and survivors of natural disasters.

Charitable giving is one way that individuals and organizations fill the needs they see in their communities. Federal, tribal, state and local governments do, of course, provide many needed services to their constituents. But in some instances, such as emergencies, charitable organizations can meet community needs faster, more efficiently and more cost-effectively. As a part of the community, they know what is needed and how to get support to intended beneficiaries quickly. In this way, they enhance the community for everyone's benefit, without drawing on the diminishing resources of government.

To encourage charitable giving, federal tax regulations include specific provisions and special allowances for individuals and organizations that make and receive donations for charitable purposes. Federal, tribal, state and local governments do not decide the purposes for which money or goods can be donated or who should receive those resources. They do, however, specify whether such donations have tax implications for donors and the direct beneficiaries of support. Specific federal regulations detail tax consequences that apply to:

- individuals and organizations who make donations,
- individuals or organizations that receive charitable donations, and
- organizations that accept money and/or goods that will be distributed to others.

Laws governing the tax consequences of charity are detailed in the Internal Revenue Code (IRC), in accompanying Treasury regulations and in rulings that the Internal Revenue Service (IRS) prepares when called upon to interpret tax law as it relates to specific situations. All who participate in charitable giving should familiarize themselves with these sources of law.

## WHAT IS A CHARITABLE ACTIVITY?

In plain English, a charitable activity can be almost anything a person or organization does without expectation of reward or repayment to improve the quality of life of another. Within the IRC, however, the term “charitable” has a specific legal meaning. It encompasses a specific range of purposes and activities including, but not limited to:

- relief of the poor, distressed and underprivileged,
- advancement of religion, education, science or the arts,
- construction or maintenance of public buildings, monuments or works,
- prevention of abuse to children or animals,
- promotion of amateur sports,
- promotion of social welfare through programs to eliminate prejudice and discrimination, defend human and civil rights secured by law, lessen neighborhood tensions and combat community deterioration or juvenile delinquency, and
- reduction of the burdens of government.<sup>1</sup>

When this definition is applied to the goals and activities of contemporary American Indian tribes, it is clear that many of their activities are both governmental and charitable in nature. For example, the protection and preservation of language might be a goal of both

governmental and charitable activities.

A second important term in this arena is *philanthropy*. Many view philanthropy—generally defined as goodwill to humankind—as synonymous with “charity.” In the nonprofit world, however, its meaning is somewhat different. The term has come to describe the formalized process of giving money or other resources for charitable activities and organizations. Thus, programs and projects that Indian tribes or others initiate to assist Native American communities are generally referred to as philanthropy.

Other fundamental terms in the charitable giving world are self-explanatory. For instance, the term used to describe the award of funds to an organization or individual to undertake charitable activities is *grantmaking*, whereas terms used for obtaining funds that will in turn be used for charitable activities are *grantseeking* and *fundraising*.

## TRIBAL TRADITIONS

In the United States today, there are more than 500 federally recognized Indian tribal governments that deliver governmental and social services to their communities.<sup>2</sup> The wide scope of tribal government services includes social services that meet the basic needs of impoverished families, educational programs that seek to increase high school graduation rates and enable Native Americans to attend college, programs that teach Native American languages, and economic development assistance for prospective Native American entrepreneurs. In all these activities, tribal governments play a critical role as advocates and supporters of their communities.

These and other programs reflect the tribal governments’ commitment to creating healthy, economically successful Native American communities. Tribal gov-

<sup>1</sup> Treas. Reg. § 1.501(c)(3)-1(d)(2).

<sup>2</sup> A note on terminology: This manual seeks to clarify the relationship between federal Indian law and the federal tax law applicable to grantmaking and grantseeking activities. To do this, the manual often uses the terms *Indian*, *Indian Tribe*, and *Indian tribal government*. These are the terms that federal law generally uses to refer to Native Americans and Native American Nations. By using these terms, the manual is able to more precisely address the relevant legal questions without creating further interpretive questions. The use of these terms is not, however, intended to express any view as to what term should or should not be used.

ernments, and the people they serve, face numerous obstacles in pursuing this goal, including the following:

- federal policy toward American Indians has been inconsistent,
- racial discrimination against Native Americans persists in many areas,
- federal and nonprofit funding for programs designed to meet tribal needs is decreasing<sup>3</sup> at a time when tribal needs are on the increase, and
- the rural nature of reservations makes service delivery difficult.

These obstacles are a continuing challenge to all Indian tribes, even those few that have experienced recent economic success.

## THE TRADITION OF SHARING

Throughout history, virtually all Native American communities have shared resources with others. Native Americans and tribal organizations have continued that tradition, adding the new and different resources of contemporary life into the mix. In 1994, American Indian grantmakers donated \$7 million to Indian causes.<sup>4</sup> Since then, tribal grantmaking and Indian participation in philanthropy have increased significantly, in part because gaming enterprises operated on some reservations have enabled a limited number of Indian tribes to increase their philanthropic activities.<sup>5</sup>

In spite of this tradition and the recent trend, most Indian tribes do not have the resources necessary to meet their community's needs. As a result, poverty is on the rise on most reservations. In 1981, when the federal courts first affirmed the sovereign rights of Indian tribes to conduct gaming on tribal lands, approximately

45 percent of Indians residing on reservations were living below the poverty level; by 1996, that figure had climbed to more than 50 percent. The rate of poverty for American Indians who reside in urban settings is twice that of other Americans.<sup>6</sup> Recent cuts in federal funding for the Indian Health Service (IHS) and Bureau of Indian Affairs (BIA) funding have made this situation worse. Overall, although the general public may perceive that gaming on Indian reservations has brought great wealth to the majority of Indian tribes, in reality, most tribal governments struggle to provide basic governmental services to their members. Fundraising and grantseeking are, therefore, necessary and important components of tribal efforts to meet community needs.

## ABOUT THIS MANUAL

In the past few years, some of the more economically successful Indian tribes have expressed interest in using a portion of their funds to establish endowments and foundations as vehicles for philanthropy. Many other Indian tribes have sought to improve their grantseeking capabilities to meet expanding needs. This manual is intended to provide the technical and legal assistance those Indian tribes and their leaders need to develop charitable giving and fundraising programs. The manual was prepared especially for:

- tribal leaders and general counsel involved in evaluating vehicles for tribal charitable giving and resolving the practical issues of giving and fundraising,
- non-Indian grantmakers who wish to understand better the unique legal status of Indian tribes

<sup>3</sup> In 1991, for instance, foundations awarded more than \$41 million for Indian causes; in 1994, however, that amount decreased to approximately \$30 million. Ewen, Alexander and Jeffrey Wollock, *Survey of Grant Giving by American Indian Foundations and Organizations*. Native Americans in Philanthropy, 1996, p. 1 (hereinafter "NAP Survey"). There has also been a decline in constant dollars in federal funding of Indian programs from \$4,212,274 billion in 1995 to \$3,963,713 billion in 1997. U.S. Senate, *Report of the Committee on the Budget of the United States to Accompany S. Con. Res. 86*, Mar. 20, 1998 (Washington: U.S. Government Printing Office), p. 218.

<sup>4</sup> NAP Survey, p. 1. See also James A. Joseph, "Options for Giving and the Native American Tradition: A Discussion Paper" (Council on Foundations: 1996) (hereinafter "Joseph, 'Options'"); and "Tribal Philanthropy: New Role for an Old Tradition," *Indian Giver* (First Nations Development Institute: Fall 1995).

<sup>5</sup> According to the latest figures, gross revenue from Indian gaming increased from \$125 million in 1985 to \$4.5 billion in 1995. General Accounting Office, *A Profile of the Indian Gaming Industry* pp. 6-9 (May 5, 1997). Approximately eight Indian tribes account for almost half of all Indian gaming revenues.

<sup>6</sup> NAP Survey, *supra* note 4 at 2.



and the special rules that govern tribal charitable activities,

- treasury and Internal Revenue Service personnel who provide guidance and issue rulings to tribal organizations on tax matters,
- accounting and management consulting firms that advise American Indian Tribes,
- national, state and local policymakers,
- national, state, tribal and local Indian organizations, and
- other nonprofit organizations.

The manual can help Indian tribes and other interested individuals and organizations determine how best to accomplish their philanthropic goals while meeting the requirements of the IRC, and applicable federal, state and tribal laws.<sup>7</sup> Its goal, however, is to raise issues and offer responsible suggestions, not to prescribe solutions or to set policy. The considerations faced by an Indian tribe that is seeking to formalize its charitable giving or fundraising program are multifaceted and are properly the subject of decisionmaking by the Indian tribe. Every Indian tribe can determine for itself what type of vehicle, if any, is most appropriate in meeting its specific needs.

The information that follows is organized to provide a basic understanding of federal charitable require-

ments and federal Indian law. Also included are descriptions of the basic options available to Indian tribes in designing charitable activities involving both grantmaking and grantseeking, examples of what Indian tribes have done to accomplish their charitable missions, and detailed information about the processes for gaining and maintaining charitable status.

At the outset in many instances, the IRC, federal Indian law and state charitable trust and corporation laws do not fit together. Indeed, several of the legal issues discussed here involve "gray areas" of those laws—areas where no clear rules or precedential guidance exist. Although this manual attempts to clarify the law, it is nearly impossible to do so in some cases without either adopting an overly conservative position or urging an approach that might trigger an IRS challenge. This manual attempts to avoid this dilemma by describing the law, not attempting to make it.

As a final note, although this manual provides substantial legal and technical information, it is no substitute for legal counsel. An attorney with expertise in this area should be retained to determine how specific laws apply to specific circumstances. Expert legal counsel is essential from the earliest stages in setting up any type of charitable foundation or fundraising program.

<sup>7</sup> Many Indian tribes are in the early stages of developing laws that regulate fundraising and grantseeking. This has made it difficult to describe tribal law requirements, and thus this discussion is limited in this manual. This is not intended to suggest that tribal law has a lesser role to play in this area. To the contrary, Indian Tribes have not only the sovereign authority, but also the greatest interest in regulating fundraising and grantseeking in Indian country. As this interest develops, it is expected that the discussion of tribal law will be elaborated further in later editions of this manual.

**To order the complete booklet**  
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## **INCLUSIVENESS STATEMENT**

The Council on Foundations was formed to promote responsible and effective philanthropy. The mission requires a commitment to inclusiveness as a fundamental operating principle and calls for an active and ongoing process that affirms human diversity in its many forms, encompassing but not limited to ethnicity, race, gender, sexual orientation, economic circumstance, disability and philosophy. We seek diversity in order to ensure that a range of perspectives, opinions and experiences are recognized and acted upon in achieving the Council's mission. The Council also asks members to make a similar commitment to inclusiveness in order to better enhance their abilities to contribute to the common good of our changing society.

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### **COUNCIL ON FOUNDATIONS**

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## FOREWORD

The traditions of gift giving and reciprocity constitute transcendent values in the Native American community, infusing the culture with much of its luminous and humanistic qualities. The practice of giving and reciprocating brings both the giver and the receiver a gift.

In an effort to give more formal structure to these traditions, an increasing number of tribal leaders and Native American philanthropists and lawyers have explored the usefulness of a different tradition, that of using the mechanisms of formalized philanthropy for personal and tribal purposes. The mechanisms of philanthropy, embodied in federal law and increasingly in tribal law, include various kinds of grantmaking and other foundations and nonprofit organizations.

It is this confluence of interests—Native American traditions and experiences with formal structures of philanthropy—that gave rise to this manual. In the 1996 *Survey of Grant Giving by American Indian Foundations and Organizations*, produced by Native Americans in Philanthropy (NAP), Alex Ewen and Jeff Wollack reported that between 1973 and 1995, the number of Native American grantmaking institutions increased tenfold. Despite this rising interest, little literature exists on how Native American communities can adopt, adapt and shape the mechanisms of formalized philanthropy to their uses and purposes. This manual serves as a resource on legal and administrative considerations in tribal giving. It incorporates the latest interpretations of tribal law, federal law and nonprofit charitable practices.

The manual carefully examines the special legal status that Indian tribes are afforded in this country. The government-to-government relationships that Indian tribes maintain with the U.S. federal government create both opportunities for and obstacles to tribal philanthropy, and this manual analyzes the many facets of this subject.

American Indian tribes have long been dynamic and resourceful in finding opportunities for their people. Their expanding interest in more formal tribal giving programs is another example of their ability to respond to their communities' needs in new and imaginative ways. Grantmaking foundations, working in collaboration with the government and the business community, can support nonprofit organizations that bring many social services to the community, help preserve local culture and traditions, and encourage young and old alike in their individual creative pursuits.

This manual grew from a common interest of two organizations, NAP and the Council on Foundations (Council), in maximizing Native American peoples' ability to participate in philanthropy beyond individual giving. The manual represents an excellent opportunity for NAP and the Council, which have long and close association on many fronts, to collaborate for the benefit of Native American communities and to enhance philanthropic practices in those communities.

The partnership of NAP and the Council reflects a larger commitment to a sharing of resources and a combining of respective experience and areas of expertise. This collaboration embodies the spirit of reciprocity that is so important in the tradition of Native American and contemporary philanthropy, and in so doing has added to the gifts that each group has brought to this venture. It is in this spirit of giving that this resource manual is offered to our readers.

Donna Chavis  
Executive Director  
Native Americans in Philanthropy

Dorothy S. Ridings  
President and CEO  
Council on Foundations

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The Council on Foundations gratefully acknowledges the contributions of a number of individuals and organizations for their leadership and assistance in conceptualizing and preparing this unique manual on the options of formalized philanthropy in Native American communities. First and foremost, the Council is indebted to its partner, Native Americans in Philanthropy (NAP), for sharing their board and staff resources, organizational contacts and intellectual capital. A true partner and collaborator in the finest sense, NAP helped to steer the project through to successful completion.

Second, the Council recognizes and appreciates the invaluable contribution made by three persons whose creativity and diligence made this publication possible. Joanne Scanlan, senior vice president of the Council; Donna Chavis, executive director of NAP; and Mindy Berry, a consultant to the Council, had the collective vision to see the need for this manual and the combined talents, dedication and knowledge to oversee the project from beginning to end.

Third, the authors of this manual, Kathleen M. Nilles, Esq., and Jeffrey A. Trexler, Esq., of Gardner, Carton & Douglas and Douglas B.L. Endreson, Esq., and Amy Locklear, Esq., of Sonosky, Chambers, Sachse & Endreson, are to be commended. They brought to this project formidable legal scholarship and deep knowledge of federal Indian law, tax law and nonprofit organization. Their biographies appear in the appendix to the manual.

Fourth, the Council acknowledges the contributions of the advisory group for the manual, composed of representatives of Native American organizations. They gave generously of their ideas, time and sage counsel, and their guidance throughout the project was invaluable. The members include: Donna Chavis, NAP; Lucille Echohawk, American Indian College Fund; Susan Jones, Eastern Band of Cherokee Indians; John Lewis, Inter Tribal Council of Arizona, Inc., Chris McNeil, Mashantucket Pequot Tribal Nation; Sean Patrick Murphy; Sherry Salway Black, First Nations Development Institute; and Richard Trudell, American Indian Resources Institute. Another member, Ingrid Washinawatok, director of the Fund for the Four Directions, provided a special section on the traditions of Native American giving.

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Sixth, the Council gratefully acknowledges the contributions of a number of individuals, only some of whom are mentioned here, whose advice and wisdom helped to shape this publication. John A. Edie, senior vice president and general counsel, and Jane C. Nober, deputy general counsel, of the Council on Foundations shared their knowledge of and insights into foundation law. They were exceptionally helpful in assisting with the overall framework for the manual. Bettye Brentley, the Council's director of Affinity Group Services and Inclusive Practices, played an invaluable role as facilitator of production. JoAnn Chase of the National Congress of American Indians, LaDonna Harris and Laura Harris of Americans for Indian Opportunity and Peterson Zah of Arizona State University were all deep wells of wisdom from which the project often replenished itself along the way.

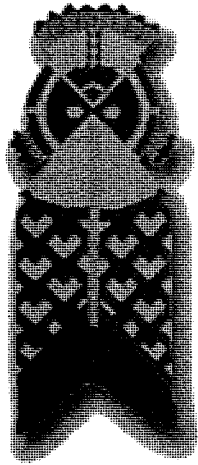
All of the organizational profiles included in this manual helped to illustrate the many possibilities of giving in Native American communities. We are particularly appreciative of: Bill Anoatubby and Lisa Jackson, Chickasaw Foundation; Chairman Apesanahkwat and Royal Warrington, Menominee Indian Tribe of Wisconsin; Sidney Armstrong, Montana Community Foundation; Barbara Bratone, American Indian College Fund; Eric Bauer, Navajo Partnership for Housing, Inc.; Marsha Crites, North Carolina Community Foundation; Fran Day and

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## CHAPTER ONE



# LEGAL AND TAX STATUS OF AMERICAN INDIAN TRIBES

A basic understanding of the rights of American Indian tribes as sovereign entities is essential to developing or formalizing charitable activities in Native American communities. These rights define the Indian tribe's legal and tax status, which is particularly relevant in the world of philanthropy. But more importantly, these rights define the framework that Indian tribes use to regulate persons and activities in Native American communities. Philanthropic organizations and their programs are, of course, subject to exercises of tribal authority. Thus, those involved in such organizations and programs should become familiar with the nature and origins or tribal sovereignty.

This chapter provides an overview of the sovereign rights of Indian tribes, a review of how Indian tribes are viewed within the mandates of the Internal Revenue Code (IRC), a description of how the Internal Revenue Service (IRS) views charitable contributions to Indian tribes, and a discussion of the special treatment of Indian tribes that are not recognized by the federal government.

## THE SOVEREIGN RIGHTS OF INDIAN TRIBES

The sovereign status and the inherent governmental powers of Indian tribes have been recognized by federal law and reaffirmed time and again by the U.S. Supreme Court.<sup>8</sup> As early as 1832, Chief Justice John Marshall wrote:

The Indian nations [have always been considered as] distinct, independent political communities, retaining their original natural rights, as the undisputed possessors of the soil, from time immemorial....<sup>9</sup>

<sup>8</sup> See, for example, *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe*, 489 U.S. 505 (1991); *California v. Cabazon Band of Mission Indians*, 480 U.S. 202 (1987); *New Mexico v. Mescalero Apache*, 462 U.S. 324 (1983); *Merrion v. Jicarillo Apache Tribe*, 455 U.S. 130 (1982); *Santa Clara Pueblo Martinez*, 436 U.S. 49 (1978). See generally, F. Cohen, *Handbook of Federal Indian Law* pp. 23-29 (1982 ed.).

<sup>9</sup> *Worcester v. Georgia*, 31 U.S. (6 Pet.) 505, 559 (1832).

The basic principles set down by Chief Justice Marshall in the historic Cherokee cases<sup>10</sup> have remained the law, and today they provide the framework for modern federal Indian law:

*As the Supreme Court held in United States v. Wheeler, reaffirming the basic framework set out in the Cherokee cases, American Indian Tribes retain all aspects of their sovereignty not withdrawn by treaty or statute, or by implication as a necessary result of their dependent status. The breadth of the Indian tribes' inherent sovereign authority was recognized in a series of decisions holding that Indian tribes are sovereign entities with the power to tax and regulate people and activities within tribal territory.*<sup>11</sup>

Indeed, irrespective of whether an Indian tribe is formally recognized by the federal government, it remains a sovereign entity with governmental powers.<sup>12</sup>

## Legal Powers

A basic right of any sovereign is the power to choose its form of government.<sup>13</sup> American Indian Tribes have exercised this right in different ways. Some Indian tribes maintain a traditional form of self-government,<sup>14</sup> and others have adopted governmental models with an executive (sometimes called a president, chairman or governor), a legislative body (such as a council or committee) and a tribal court system. Still others have combined these two forms.

As sovereign nations, American Indian tribes have the authority to enact civil and criminal laws to protect persons and property and to regulate activity within the tribal jurisdiction. This legislative authority includes the

power to charter and regulate corporations, including nonprofit organizations. These powers are subject to certain federally imposed limitations. The judicial power of American Indian Tribes is typically exercised through tribal courts. Tribal courts, which include tribal and appellate tribunals, exercise criminal jurisdiction over American Indians who violate tribal law and civil jurisdiction over all persons and property within tribal territory.<sup>15</sup> Like other sovereigns, tribal governments cannot be sued unless they have clearly waived their sovereign immunity.<sup>16</sup>

The jurisdiction of American Indian tribes involves many complex legal issues that are beyond the scope of this manual. In general, the territory over which tribal governments exercise jurisdiction is the Native American community, which includes all lands within the reservation, trust lands outside reservation boundaries and dependent Indian communities.<sup>17</sup> As the Supreme Court acknowledged in a recent opinion, the reach of tribal jurisdiction is not limited to land formally designated as trust land or a reservation. Rather, it extends to all lands "validly set apart for use of the Indians, as such, under the superintendence of the government."<sup>18</sup>

## Roles in Service Delivery

Tribal governments also deliver a broad range of health, education, social welfare and economic services to reservation residents and businesses. For example, departments or divisions of tribal governments provide fire and police protection, public utilities, road maintenance, educational (K-12) and health services, social services and job training. Some Indian tribes also operate tribal community colleges.

<sup>10</sup> *Worcester v. Georgia*, *supra*; *Cherokee Nation v. Georgia*, 30 U.S. (6 Pet.) 1 (1831).

<sup>11</sup> Douglas B.L. Endreson, "The Challenges Facing Tribal Courts Today," 79 *Judicature* 1, 143 (Nov.-Dec. 1995) (footnotes omitted).

<sup>12</sup> Cf. Presidential Memorandum of Apr. 29, 1994, "Government-to-Government Relations with Native American Tribal Governments," 59 Fed. Reg. 22,951 (May 4, 1994).

<sup>13</sup> American Indian Lawyer Training Program, *Indian Tribes as Sovereign Governments*, (AIRI Press 1988), at p. 39.

<sup>14</sup> See *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 62-63 (1978); *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195 (1985).

<sup>15</sup> Endreson, *supra* note 11 at 143.

<sup>16</sup> Other sovereign powers retained by Indian nations include the power to administer justice and enforce laws, tax, define conditions for membership in the nation, regulate domestic relations of members, and regulate property use. See generally, Kickingbird, Kirk, et al., *Indian Sovereignty* (Institute for Development of Indian Law 1977); *Indian Tribes as Sovereign Governments*, *supra* note 13.

<sup>17</sup> The definition of Indian Country is found at 18 U.S.C. § 1151.

<sup>18</sup> *Oklahoma Tax Commission v. Citizens Band of Potawatomi Indians*, 498 U.S. 505, 507 (1991).



## Roles in Economic Development

Overall, Indian tribes play a critical role in determining how communities develop economically. Tribal involvement in economic development may take different forms in different instances. For example, tribal governments are, in growing measure, responsible for managing the Indian tribe's natural resources and the environmental quality of tribal territories. To fund these and other activities, some tribal governments impose and collect taxes or fees on activities and persons located or doing business within tribal territory. Others, like some states, own and operate revenue-generating enterprises. Some enterprises market tribal natural resources, whereas others engage in manufacturing or service businesses, including gaming. These enterprises provide revenues to fund services offered by the tribal government, increase the diversity of the local economy on and off the reservation and provide employment for Indians and non-Indians alike.

Despite these benefits, tribal involvement in certain business-type activities has led some to contend that Indian tribes—but not states—should be treated like investor-owned corporations (and tribal members as corporate shareholders). Indian tribes, like states, use revenue-generating enterprises to meet their governmental responsibilities. Indeed, it was the similarity between Indian tribes and states that led Congress in 1982 to pass the Indian Tribal Governmental Tax Status Act (IRC Section 7871). This legislation treats Indian tribes like states for most federal tax purposes.

## TREATMENT OF INDIAN TRIBES AS STATES UNDER SECTION 7871

The IRC provides a number of tax benefits for state and local governments that perform activities associated with carrying out government operations—including the deductibility of contributions to such gov-

ernments, if the contributions are for activities that have exclusively public purposes.

Tribal governments have not been ignored in this regard. The Indian Tribal Governmental Tax Status Act<sup>19</sup> formally recognized that tribal governments perform many of the same public service functions as states, and it extended to Indian tribal governments many of the same tax benefits afforded to states, based on this justification.<sup>20</sup> Significantly for current purposes, IRC Section 7871 of this law treats Indian tribes as states for purposes of determining “whether and in what amount” a contribution to a tribal government is deductible as a charitable contribution under IRC Section 170. Among the other tax benefits secured by Section 7871 are the following benefits, which are also enjoyed by states:

- parallel estate and gift tax deductibility for gifts and bequests,
- tax-exempt bond financing authority,
- exemption from various excise taxes (generally limited to transactions involving the exercise of a governmental function), and
- treatment as a state government under the private foundation excise tax rules.

Although it might appear that Section 7871 puts Indian tribes on the same footing as states in all respects relevant to their tax status, this is not the case. Section 7871 does not, for example, treat Indian tribes as states for unemployment tax purposes.

To qualify for the tax benefits enumerated in Section 7871, a tribal government must be recognized by the Department of the Treasury as an entity that exercises sovereign powers. The Treasury Department makes this determination in consultation with the Department of the Interior, which generally means that in practice, only federally recognized Indian tribes are eligible for Section 7871 treatment.<sup>21</sup>

<sup>19</sup> Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, 96 Stat. 2607 (codified as amended at 26 U.S.C. § 7871).

<sup>20</sup> Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, 96 Stat. 2607 (codified as amended at 26 U.S.C. § 7871); and S. Rep. No. 646, 97th Cong., 2d Sess. 11 (1982).

<sup>21</sup> *But see* Priv. Ltr. Rul. 8607098 (Nov. 20, 1985) discussed on page 11 in footnote 52, where the IRS ruled that a non-federally recognized Indian tribe was eligible for § 7871 status. Rev. Proc. 83-87, 1983-2 C.B. 606, provides a list of Indian Tribal Governments that are treated as states for the federal tax purposes specified in IRC § 7871. This list is not all-inclusive; Indian tribes not initially included can request § 7871 treatment through a private ruling request. 21 Rev. Proc. 84-36, 1984-1 C.B. 510, provides a list of subdivisions of tribal governments that are to be treated as political subdivisions of states under IRC § 7871.

Section 7871 also permits subdivisions of tribal governments to qualify for treatment as a state, if they exercise a sovereign power—such as the power to tax, the power of eminent domain or police powers.<sup>22</sup>

The unique status of Indian tribes with regard to tax exemptions and charitable activities is described below.

## TAX STATUS OF INDIAN TRIBES

Federally recognized American Indian tribes are governments. They are not voluntary charitable entities,<sup>23</sup> and they are not organized as nonprofit or charitable corporations—although an Indian tribe may decide to form such an entity. As governmental entities, Indian tribes, like states, enjoy two essential tax advantages under federal law:

- immunity from state and federal income tax, and
- eligibility to receive deductible charitable contributions.

Nevertheless, the IRC does not treat Indian tribes like states for all federal tax purposes. For example, the IRC provision that classifies governmental units as public charities on a per se basis does not explicitly apply to tribal governments. Thus, under current tax law, when an Indian tribe creates a separately incorporated charitable entity, it is more difficult to determine whether that entity will qualify as a public charity or a private foundation. (This issue is discussed in detail in Chapter 2.)

## Status of Tribal Governments and Wholly Owned Tribal Corporations

As sovereign governments, American Indian Tribes are not subject to federal income tax. Moreover, the IRS has consistently ruled that Indian tribes are not taxable entities,<sup>24</sup> and has recognized that federally chartered tribal corporations have the same tax status as Indian tribes.<sup>25</sup> Although the IRC includes no specific exemption provision for Indian tribes, IRS revenue rulings issued in 1967 and 1981 expressed the rationale for tribal tax immunity as follows:

*Income tax statutes do not tax Indian Tribes. The Tribe is not a taxable entity.*<sup>26</sup>

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*[T]he political entity embodied in the concept of an Indian Tribe has long been recognized and no tax liability has been asserted against a Tribe with respect to tribal income from activities carried on within the boundaries of the reservation.*<sup>27</sup>

Thus, Indian tribes and most wholly owned tribal corporations are immune from federal income tax. (This statement does not, however, apply to individuals; Native Americans are generally not immune from personal federal tax liabilities.<sup>28</sup>)

A 1994 IRS ruling further clarified the scope of tax immunity granted Indian tribes in two respects:<sup>29</sup>

- First, it made clear that there is no “reservation boundary” limitation on tribal tax immunity. Thus, an Indian tribes’ income, whether derived from on-reservation or off-reservation activities, is not subject to income tax.

<sup>22</sup> Rev. Proc. 84-36, 1984-1 C.B. 510, provides a list of subdivisions of tribal governments that are to be treated as political subdivisions of states under IRC § 7871.

<sup>23</sup> As the Supreme Court has stated, Indian tribes are “a good deal more than ‘private, voluntary organizations’...” *United States v. Mazurie*, 419 U.S. 544, 557 (1975).

<sup>24</sup> Rev. Rul. 67-284, 1967-2 C.B. 55; Rev. Rul. 94-16, 1994-1 C.B. 46. As formal revenue rulings, these administrative pronouncements have been reviewed and approved by the Treasury Department.

<sup>25</sup> See Rev. Rul. 81-295, 1981-2 C.B. 15; Rev. Rul. 94-16, *supra* note 22; and B. Bittker, *Federal Taxation of Income, Estates and Gifts*, para. 1.2.9 (1981).

<sup>26</sup> Rev. Rul. 67-284, 1967-2 C.B. at 56.

<sup>27</sup> Rev. Rul. 81-295, 1981-2 C.B. 15, 16.

<sup>28</sup> See *Squire v. Capoeman*, 315 U.S. 1, 6 (1956) (holding that individual Indians are subject to income taxes unless the income-generating activity is governed by a treaty or remedial legislation). Rev. Rul. 67-284 also states that tribal income is taxable to individual members of the Indian tribe, but only when distributed or constructively received by them.

<sup>29</sup> Rev. Rul. 94-16, 1994-1 C.B. 46.

- Second, it held that tribally owned, state-chartered corporations do not share the tax-immune status of the Indian tribe.<sup>30</sup> The ruling did not, however, clarify the tax status of tribally chartered corporations.<sup>31</sup>

Whether federal income tax immunity applies to state-recognized Indian tribes remains somewhat unclear. The 1967 IRS ruling applied to all Indian tribes, while the 1994 ruling addressed itself specifically to federally recognized Indian tribes. In a 1996 training manual, the IRS stated that “[g]enerally, an Indian tribe must be recognized by the Department of the Interior to be treated as such for federal income tax purposes.”<sup>32</sup> The IRS, however, did concede that it is not necessary for an Indian tribe to meet the specific requirements of Section 7871 to be treated as an Indian tribe for federal income tax purposes.<sup>33</sup>

The legislative history of the Indian Tribal Governmental Tax Status Act of 1982<sup>34</sup> confirms that Congress did not intend to change the income tax

treatment of Indian tribal governments set forth in Revenue Ruling 67-284, which holds that American Indian Tribes are not taxable entities.<sup>35</sup> The general purpose of the Act was to help tribal governments’ development efforts by providing such governments with tax benefits similar to those held by the states.<sup>36</sup>

Several revenue rulings affirm that states, like Indian tribes, are not considered taxable entities for federal income tax purposes.<sup>37</sup> Like states, Indian tribes have a broad immunity from income tax that, with one exception, is not limited by unrelated business income tax (UBIT) rules.<sup>38</sup> Thus, any activity conducted by the Indian tribe is immune from income tax.<sup>39</sup> In contrast, organizations exempt from tax because they have been granted public charity status by the IRS are subject to the UBIT.<sup>40</sup>

During the years, some tribal organizations have sought charitable status under the mandates of the IRC. Currently, the IRS’ position is that an Indian tribal government does not qualify for exemption as a charitable organization because, like a state, it exercises sov-

<sup>30</sup> This administrative position is reinforced by the *IRS Indian Assistance Manual*, which directs state-chartered corporations to file the “appropriate corporate tax return... such as Form 1120.” *IRS Indian Assistance Manual*, p. 8.

<sup>31</sup> The tax status of tribal-chartered corporations formed and controlled by an Indian tribe remains under study by the IRS. See Treasury Dec. No. 8697, 61 *Fed. Reg.* 66585 (Dec. 17, 1996) (Treasury and the IRS are studying the issue of the tax treatment of entities wholly owned by a tribe and incorporated under tribal law). The IRS has indicated informally that it will consider the tax status of tribally chartered corporations on a case-by-case basis. Under existing tax law precedents, a tribally chartered corporation arguably should be treated as tax-immune if it operates as an “integral part” of the tribal government, see pp. 25-27. *Cf.* Treas. Reg. § 301.7701-1(a)(3) (an organization wholly owned by a state is not recognized as a separate entity for federal tax purposes if it is an integral part of the state).

<sup>32</sup> *IRS Indian Assistance Handbook*, p. 7.

<sup>33</sup> IRC § 7871 extends certain tax benefits to Indian tribal governments, a term defined to include the “governing body of any Tribe, band, community, village, or group of Indians or (if applicable) Alaska Natives, which is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions.” See §§ 7871 and 7701(a)(40).

<sup>34</sup> Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, 96 Stat. 2607 (codified as amended at 26 U.S.C. § 7871).

<sup>35</sup> S. Rep. No. 646, 97th Cong., 2d Sess. 8, 12 (1982); H. Conf. Rep. No. 984, 97th Cong., 2d Sess. 15-16 (1982).

<sup>36</sup> S. Rep. No. 646 at 11.

<sup>37</sup> See for example, Rev. Rul. 71-131, 1971-1 C.B. 28 (Lawyer Trust Account Fund created by state); Rev. Rul. 71-132, 1971-1 C.B. 29 (liquor stores operated by state); and Rev. Rul. 87-2, 1987-1 C.B. 18 (liquor stores operated by state).

<sup>38</sup> In the case of both Indian tribes and states, the only exception to this general rule is the IRC’s application of UBIT to state-owned and tribal-owned colleges and universities. See IRC §§ 511(a)(2)(B) and 7871(a)(5). In recent years, the U.S. Congress’ Ways and Means Committee twice considered provisions that would tax gaming and other business activities of Indian tribes. In 1995, a House-passed provision to impose a UBIT-style tax on Indian tribes was dropped in conference; in 1997, members of the Ways and Means Committee voted 22 to 16 to strike the UBIT provision from H.R. 3014.

<sup>39</sup> On first glance, the tribal tax exemption appears to be even broader than the exemption afforded to states under IRC § 115. IRC § 115 provides that gross income does not include any income that accrues to a state or territory, or any political subdivision thereof, if such income is “derived from any public utility or the exercise of any essential governmental function.” But this section of the IRC only provides a supplementary basis for the tax exemption of state-owned entities and thus does not limit the essential tax immunity of the states themselves.

<sup>40</sup> See IRC §§ 511-514. *Unrelated business income* is defined broadly to include any income from a trade or business regularly carried on by the organization if the trade or business is not substantially related to the organization’s exempt purpose. See IRC § 513 and Treas. Reg. § 1.513-1. See Chapter 5 for a more complete discussion of unrelated business income.

ereign powers.<sup>41</sup> (The exercise of sovereign governmental powers is not included in the range of charitable purposes set forth in IRC.<sup>42</sup>)

An entity established and controlled by an American Indian Tribe may, however, obtain recognition as a tax-exempt charitable organization or a social welfare organization.<sup>43</sup> But to obtain such recognition, the entity must be separate and distinct from the Indian tribal government, and it must be organized and operated exclusively for a charitable or social welfare purpose.<sup>44</sup> Tax-exempt charitable organization status can provide benefits in fundraising, postal rates and joint activities with other charities. Note, however, that tribal corporations with exempt status under the IRC are subject to applicable UBIT and other restrictions.<sup>45</sup>

### Status of Tribal Subdivisions and Government Units

Although tribal governments are the primary intended beneficiaries of Section 7871 status, political subdivisions of Indian tribes and tribal governmental units

termed "integral part" entities can also benefit from such status. Tribal political subdivisions can qualify for Section 7871 treatment if they exercise sovereign powers.<sup>46</sup> In a recent private letter ruling, the IRS recognized an intertribal organization as a political subdivision.<sup>47</sup>

The IRS has not published formal guidance on criteria for qualifying as an integral part of an Indian tribe, but it has issued a number of private letter rulings that address such status in the context of Section 7871.<sup>48</sup> These rulings point to certain factors as evidence of integral part status:

- the degree of control that the tribal government exerts over the governmental agency,
- whether the tribal government is liable for the acts of the agency, and
- whether agency resolutions must be approved by the tribal government.

As a result of these rulings, Section 7871 status has been granted to tribal business entities,<sup>49</sup> a tribal court

<sup>41</sup> See Internal Revenue Manual, *Exempt Organizations Handbook* (7751), § 34(12)7; General Counsel Memorandum (GCM) 38825 (Mar. 10, 1982). The *Exempt Organizations Handbook*, as well as the *Private Foundation Handbook*, are intended by the IRS for use as a training or research aid. Although they represent the current thinking of the IRS, they are not meant to "extend published authority" and may not be cited as "precedent or authority in the disposition of cases." Internal Revenue Manual (7700) §§ 7750-7752.

<sup>42</sup> Rev. Rul. 60-384, 1960-2 C.B. 172.

<sup>43</sup> A § 501(c)(4) organization is, like a 501(c)(3) entity, exempt from federal income taxation. It is, however, a social welfare organization, not a charitable organization and contributions to it are not tax deductible. A § 501(c)(4) organization is not subject to the limits on lobbying that apply to § 501(c)(3) entities.

<sup>44</sup> GCM 38825, *supra* note 41.

<sup>45</sup> See for example, GCM 38825. In GCM 38825, a wholly owned tribal corporation that operated a general store obtained tax-exempt status under IRC § 501(c)(4). As a general rule, such an entity would be subject to the UBIT. In this instance, however, because it provided a community benefit by serving the needs of residents in an isolated area, its business activity was not considered an "unrelated" trade or business.

<sup>46</sup> See Rev. Proc. 84-36, *supra* note 18.

<sup>47</sup> In Priv. Ltr. Rul. 9409031 (Dec. 7, 1993), 12 separate tribes formed an agency to which they delegated a substantial governmental function. The ruling recognizes the agency as a political subdivision of 11 of the 12 tribal governments.

<sup>48</sup> Under IRC § 6110(j)(3) only the taxpayer requesting the private letter ruling can rely on it for tax purposes. Private letter rulings do, however, generally provide some guidance in analyzing a particular issue.

<sup>49</sup> In Priv. Ltr. Rul. 8527064 (Apr. 10, 1985), a tribal government organized several economic subsidiaries engaged in logging and sawmill operations, farming activities, construction activities, retail sales and the operation of recreational facilities. All property of these entities was held by the tribe, X, Y, the governing body of X, provided the overall management for the entities. In ruling that the entities were eligible for the exemptions from excise taxes pursuant to IRC § 7871(a)(3), the IRS noted that:

[a]s is the case of governments generally, Y performs governmental functions through agencies such as its police department, court systems, and schools. Such agencies are not separate entities, but rather are the government itself. The same can be said of the Enterprises [the entities]. These businesses are not political subdivisions of Y or separate incorporated companies; they are Y. They are properly characterized as X doing business as a, b, c, d, e, or f.

Based on these observations and the fact that the Indian tribe itself was eligible for treatment as a state under IRC § 7871 because it was listed in Rev. Proc. 83-87, the IRS concluded that the economic subsidiaries of the tribal government were eligible for the exemptions from excise taxes under IRC § 7871(a)(2).

system,<sup>50</sup> a tribal tax commission<sup>51</sup> and a tribal community organization.<sup>52</sup> Private letter rulings issued to state government entities indicate that the IRS looks at similar factors in analyzing the integral part status of state governmental units.<sup>53</sup>

### **Status of Tribally Owned, State-Chartered Corporations**

In applying for a private letter ruling under Section 7871 for purposes of qualifying as a government agency, tribal governments should keep in mind that the IRS has taken the position that state-chartered corporations, even though wholly owned by a tribal government, are separate taxable entities.<sup>54</sup> (The IRS has also implied that tribally chartered corporations wholly owned by the tribal government are taxable entities.<sup>55</sup>) Separate incorporation under state or tribal law should not preclude a finding of integral part status for Section 7871 purposes.<sup>56</sup> As a practical matter, however, the IRS is much more likely to delay, or even decline, to rule on

the status of a separately incorporated tribal governmental entity.

### **Tax Treatment of Other Tribal Governments and Organizations**

Not every Indian tribe is recognized as such by the federal government. Moreover, the historical relationship between Native Alaskan tribes and the federal government is, in some ways, distinct from the relationship between Indian tribes in other states and the federal government. Because of these issues, the tax treatment of nonfederally recognized Indian tribes and Native Alaskan tribes is discussed separately below.

#### *State-Recognized Indian Tribes*

A number of American Indian tribes are recognized by a state, but not the federal, government. Referred to as nonfederally recognized or state-recognized Indian tribes, the governments of these Indian tribes appear to

<sup>50</sup> In Priv. Ltr. Rul. 8543016 (July 12, 1985), the IRS determined that a tribal court system was not a political subdivision of the tribal government, but instead an instrumentality or integral part of the government. The IRS noted that, "Not all operating units within the structure of a government... are political subdivisions. For example, a legislative body, is an instrumentality or an arm of the government and functions as an integral part of it. Such entities are not political subdivisions but are the government itself, for a government functions only through the activities of its various departments and operating units." The IRS concluded that, "[b]ased on the foregoing... we conclude that Y is not a political subdivision of X. We find however, that since Y is the judicial arm of X, it is an instrumentality, or an integral part of X. Since X has been recognized as an Indian Tribal government... all federal tax benefits under IRC § 7871 that accrue to X by virtue of this designation, are shared with Y."

<sup>51</sup> In Priv. Ltr. Rul. 8702017 (Oct. 9, 1986), the IRS held that a tribal tax commission was not a political subdivision of the Indian tribe, but because it performed an essential governmental function, that is, the enforcement of the tax law, it was an integral part of the Indian tribe. The Indian tribe itself was listed in Rev. Proc. 83-87 as eligible for treatment as a state status under IRC § 7871, therefore, the IRS concluded that "the federal tax treatment under IRC § 7871 that accrued to X Tribe by virtue of this recognition, is shared with Y Tax Commission."

<sup>52</sup> In Priv. Ltr. Rul. 8950017 (Sept. 15, 1989), the IRS ruled that although a community organization of an Indian tribe was not a political subdivision, it was an integral part of the tribe and as such, eligible for certain benefits under 26 U.S.C. § 7871. In analyzing whether the organization was an integral part of the tribe, the IRS examined the degree of separateness between the organization and the tribal government. The level of direct control that the government exercised over the organization and the government's liability for acts of the organization were factors the IRS considered in assessing separateness. The IRS noted that the government controlled the financial activities of the organization and that the organization's governing charter required the government to approve organization resolutions. Despite the evidence that the charter resembled a corporate charter of an independent entity, the IRS concluded that the government exercised the required control over the organization such that it constituted an integral part of the government.

<sup>53</sup> In Priv. Ltr. Rul. 8429012 (Apr. 6, 1984), the IRS concluded that mental health authority was an integral part of the government of N and not a separate corporation or organization, because the state delegated it the authority, "to serve as the comprehensive planning, budgeting, implementing, and monitoring group" for community-based health programs and under that state's law, providing community health services was an obligation of the government to its citizens.

<sup>54</sup> See Rev. Rul. 94-16, 1994-1 C.B. 19.

<sup>55</sup> Although the IRS has not taken an official position on the status of tribally-chartered corporations that are wholly owned by the tribal government, its proposed regulations under IRC § 337 imply that such corporations are taxable entities. On January 15, 1997, the IRS published proposed regulations that would require a taxable corporation to recognize gain on the transfer of all or substantially all of its assets to a tax-exempt entity. 62 Fed. Reg. 2064. Section 1.337(d)-4(c)(2)(iv) & (v) includes within the definition of "tax-exempt entity" a tribal government under § 7701(a)(4), the subdivisions, agencies and instrumentalities of a tribal government, and a federally-chartered § 17 IRA corporation. A tribally-chartered corporation is absent from this definition. IRC § 1.337(c)(2)(viii), however, provides another category of tax-exempt entities that would not be taxable, "for reasons substantially similar to those applicable to any entity listed in this paragraph (c)(2)...." 62 Fed. Reg. 2064.

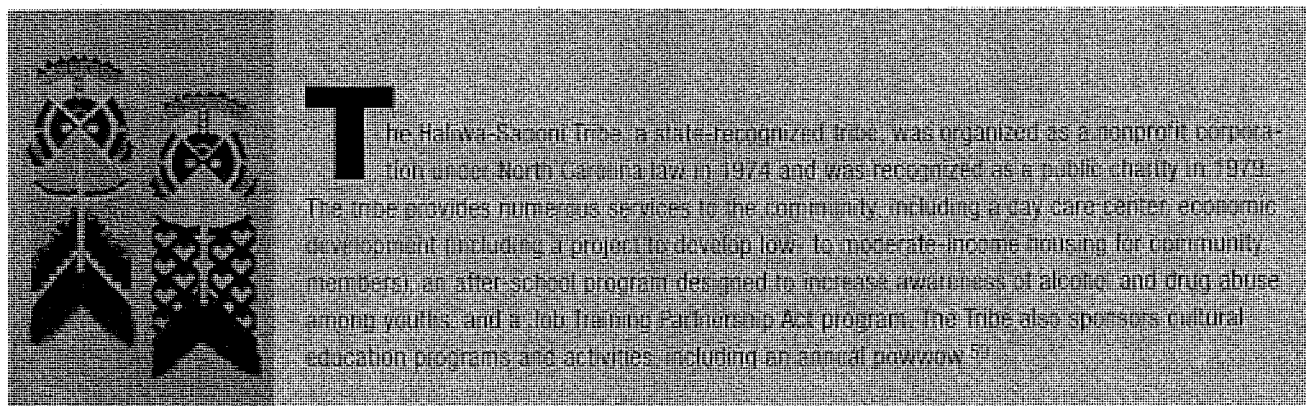
<sup>56</sup> As the Supreme Court's stated in *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 157 n.13 (1973), "the question of tax immunity [for a § 17 Indian Reorganization Act corporation] cannot be made to turn on the particular form in which the Tribe chooses to conduct its business."

be ineligible for Section 7871 status.<sup>57</sup> Some state-recognized Indian tribes exercise sovereign powers over activities and persons on state reservations. Others, in particular those without a land base, do not. In either case, state-recognized Indian tribes may retain sovereign immunity, deliver government services and exercise governmental powers over internal relations.

State-recognized Indian tribes exercising sovereign powers may obtain the benefits of Section 501(c)(3) status, but only if they create a separate entity that meets the organizational and operational tests of Section 501(c)(3). To be considered separately organized, the entity must establish that it is either a corporation, a trust or an association. Moreover, the IRS has stated that an application for recognition of tax-exempt status from an entity created by, but separate from, a state-recognized Indian tribe will be rejected if the separate entity exercises sovereign powers.<sup>58</sup> Of course, a state-recognized Indian tribe not exercising substantial sovereign powers may elect to organize itself as a charitable entity that delivers educational or other charitable services to tribal members.

The potential advantage of organizing a separate entity to serve as the grantseeking arm of the state-recognized tribal government is that such an arrangement may increase donations that in turn could be dedicated to tribal government purposes. There are, however, potential complications. One question that arises is whether a public charity that serves as an intermediary can count as public support donations earmarked by the donor for ultimate distribution to another entity that is not a public charity. (See Chapter 2 for a more detailed discussion of public support.) Furthermore, other factors, including the uncertainty associated with the federal tax status of state-recognized Indian tribes and the lack of clarity regarding whether donations to such a separate legal entity that are ultimately distributed to the Indian tribe or its departments would be tax deductible, make planning in this area difficult.

Ultimately, whether to organize a separate organization for charitable or other purposes is, of course, a decision for the Indian tribe. The significance of these issues to the Indian tribe, however, makes it essential to obtain legal advice before action is taken.

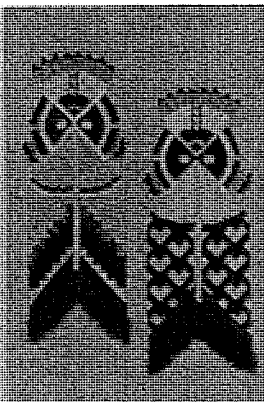


<sup>57</sup> See definition of tribal government under § 7701(a)(40). Informal conversations with the IRS indicate that it defers to the BIA on the status of tribes and will not make an independent determination of that status. *But see* Priv. Ltr. Rul. 8607098 (Nov. 20, 1985), wherein the IRS ruled that a tribe not recognized by the federal government (but recognized by the state in which it was situated) and exercising sovereign powers was eligible for § 7871 treatment as a state.

<sup>58</sup> See Internal Revenue Manual, *Exempt Organizations Handbook* (7751), at § 34(12)7.12.

<sup>59</sup> Source: Program for *Haliwa-Saponi Indian Tribe 32nd Annual Pow-Wow* at p. 55 (1997); and material supplied by the Haliwa-Saponi Tribe, the North Carolina Corporation Commission and the North Carolina Commission on Indian Affairs.

**T**he Meherrin Indian Tribe, the Accohannock Indian Tribe, the Central Florida Muscogee Creek Tribe and the Chicora Indian Tribe of South Carolina—all state-recognized tribes—have been recognized by the IRS as 501(c)(3) organizations eligible to receive tax-deductible charitable contributions.<sup>60</sup>



Several Indian tribes have sought and obtained recognition as charitable when they determined that contributions to them did not qualify for deductibility under IRC Section 7871. They were granted charitable organization status on the basis of the cultural and educational activities in which they engaged, not their governmental status.

Finally, it is important to note the distinction between organizing the sovereign entity itself (or one of its departments) as a federally recognized charitable organization and the creation of a separate corporate entity by the tribal government that is intended to fulfill one or more purposes of a federally recognized charitable entity. The purposes may overlap with governmental responsibilities. That is, a tribal government—whether federal or state recognized—may wish to form a federally recognized charitable entity for any number of purposes related to its governmental responsibilities, such as establishing a scholarship fund, a boys' and girls' club, a tribal museum or library or to operate social and health programs for the elderly. In these instances, the role of the charitable entity supplements the government's responsibilities. Forming such a corporation does not necessarily require that the government cede or delegate any of its sovereign authority.

### *Native Alaskan Organizations and Tribes*

Alaskan Tribes account for 226 of the more than 500 federally recognized Indian tribes. Approximately one-third of the Indian tribes in Alaska (approximately 72 entities) are organized under the Indian Reorganization Act—others are governed by traditional village councils.<sup>61</sup> All of the Indian tribes in Alaska are federally recognized and are, therefore, generally eligible for Section 7871 status.<sup>62</sup>

A unique aspect of tribal governments in Alaska is the manner in which they deliver governmental services such as health care, job training, housing, education and welfare programs. For many of the Indian tribes, some or all of these programs are administered through sixteen intertribal consortia, most of which are recognized by the IRS as tax-exempt, charitable, nonprofit corporations chartered under state law. These consortia receive funding from the state and federal governments, as well as private foundations and other public sources. The bulk of their funding stems from contracting or compacting activities under the Indian Self-Determination Act.<sup>63</sup> In this regard, note that several of the larger village Indian tribes operate most of their service programs independently from the consortium to which they belong.

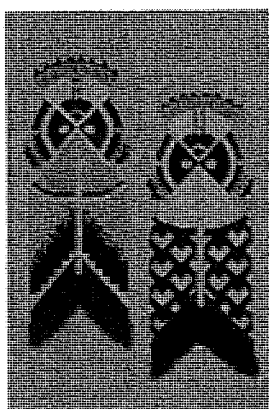
<sup>60</sup> The Central Florida Muscogee Creek Tribe was recognized as a public charity under § 509(a)(2), whereas the others obtained public charity status under § 509(a)(1). See Bureau of National Affairs, Daily Tax Report, Oct. 10, 1995, Aug. 29, 1995, May 10, 1994, and Jan. 20, 1994.

<sup>61</sup> 25 U.S.C. § 476. See *supra* note 12 and accompanying text.

<sup>62</sup> Rev. Proc. 83-87, 1983-2, C.B. 606.

<sup>63</sup> 25 U.S.C. §§ 450 et seq.





**T**he Bristol Bay Native Association (BBNA) was founded in 1966 by 15 Native Alaskan villages. Incorporated under Alaska law in 1973, BBNA was recognized as a public charity by the IRS. Although the initial focus of BBNA was the settlement of land claims of Native villages, the association now serves as a community and social services agency as well as a resource for its 30 member tribal governments in the Bristol Bay Region. Village tribal councils authorize the BBNA to enter into self-determination contracts and self-governance compacts on their behalf with the Department of the Interior, the Bureau of Indian Affairs and the Department of Health and Human Services. It is through these contracts and compacts, and contracts with the state, that BBNA receives funding and delivers services to its 4,600 individual members and member village governments. BBNA provides individual members with numerous services through education, job training, vocational rehabilitation, and elderly, children and family violence prevention programs. It promotes the goals of its member tribal councils by providing economic development services, law enforcement personnel and acquisition and management services through its realty department, natural resources and environmental management services.<sup>64</sup>

## DEDUCTIBILITY OF CONTRIBUTIONS

IRC Section 7871 treats Indian tribes as states for purposes of determining "whether and in what amount" a contribution to a tribal government is deductible as a charitable contribution under Section 170. To receive tax deductible contributions, the Indian tribe or tribal government entity must be recognized by the Depart-

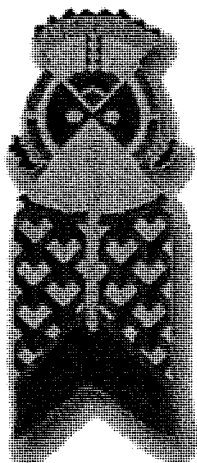
ment of the Treasury as an entity that exercises sovereign powers. The Treasury makes this determination in consultation with the Department of the Interior. The only limitation, which applies equally to states and other governmental entities, is that the contribution must be made for exclusively public purposes.<sup>65</sup>

<sup>64</sup> Source: *Bristol Bay Native Association 1997 Annual Report*, p. 19-29; and material supplied by The Bristol Bay Native Association.

<sup>65</sup> IRC § 7871(a)(1). See, e.g., Rev. Rul. 77-232, 1977-2 C.B. 71 (contribution to State Bar Association ruled not for exclusively public purposes); Rev. Rul. 74-3612, 1974-2 C.B. 159 (contribution to volunteer fire department met public purpose test).



## CHAPTER TWO



# EXEMPT ORGANIZATIONS AND THE CHARITABLE ACTIVITIES THEY MAY UNDERTAKE

**O**ften, the rights that flow from status as a sovereign nation are sufficient for developing effective, self-directed, tribal philanthropic programs and organizations. But even in these instances, obtaining charitable organization status may provide additional benefits to a tribal grantmaking or grantseeking organization. Such status clarifies many issues—both for the charitable organization and for potential donors. This chapter provides an overview of the basic forms of charitable organizations, the tests used to determine whether a tribal organization qualifies as such an entity and the rules that govern activities and donations to public charities and their private counterparts. The chapter concludes with a comparison of Section 7871 and Section 501(c)(3) status.

Much of what is described here has roots in traditional concepts of charitable giving; in large part, the definitions and regulations apply to the activities of charitable and other organizations that assist Native Americans and their communities through educational, medical, cultural, economic and other support, and other initiatives to improve the quality of life in Native American communities.

## WHAT CONSTITUTES A CHARITABLE ORGANIZATION?

Every society and culture has its own forms of charitable organizations. Some are more formal than others. In some societies, charitable organizations consist of civic groups, such as a neighborhood association, or religious organizations, such as a church or a synagogue. Other societies may promote more formal charitable organizations, such as private foundations and government-sponsored agencies, to support public social services.

Under federal law, the designation “tax exempt” has a very specific legal meaning. This legal definition is contained in Section 501(c) of the Internal Revenue Code (IRC). Entities that are “organized and operated” exclusively for charitable purposes are classified under Section 501(c)(3).

Section 501(c)(3) organizations fall into five categories and include governmental units.<sup>66</sup> For regulatory purposes, these organizations are generally broken in two groups—public charities and private foundations. Under

<sup>66</sup> Certain government units fall within the publicly supported organization category. This classification does not mean that governmental units are § 501(c)(3) organizations. Instead, the inclusion of these governments within this category facilitates other objectives of nonprofit tax law, such as determining the tax status of government-controlled foundations and facilitating private foundation grants.

Section 509 of the IRC, public charities are further broken down according to the type of support they receive. The following is a description of the relevant types of charitable organizations. The first four categories are referred to generically as public charities. Although public charities are usually designed both to raise funds and provide services, some also make grants.

- Publicly supported organizations. Described in IRC Section 509(a)(1) and also known as 170(b)(1)(A) groups, publicly supported organizations include churches, schools, hospitals, certain governmental units and organizations that meet criteria demonstrating a sufficient level of "public support" through contributions or other forms of community contact and involvement (such as community foundations). Governmental units are further defined as:

- states,
- United States possessions,
- political subdivisions of a state or possession,
- the United States,
- the District of Columbia, and
- Indian tribal governments.<sup>67</sup>

- Gross receipt organizations. Described in IRC Section 509(a)(2), gross receipt organizations normally receive more than one-third of their support from gifts, grants, fees and gross receipts from admissions and sales of merchandise or services. They do not normally receive more than one-third of their support from investment income.
- Supporting organizations. Described in IRC Section 509(a)(3), supporting organizations although not publicly supported, are controlled and closely associated with one or more public charities (including community foundations and certain governmental units) or other broadly supported groups.

- Public safety organizations. Described in IRC Section 509(a)(4), public safety organizations operate exclusively for testing for public safety.
- Private foundations. Including all 501(c)(3) organizations, private foundations do not qualify as publicly supported, gross receipts or supporting organizations—public charities—or public safety organizations.

All entities that qualify for, and are granted, Section 501(c)(3) organization status by the IRS are exempt from federal income taxes.

To achieve IRS recognition as a 501(c)(3) entity, an organization must satisfy three sets of criteria. The first test determines whether it has a charitable purpose. The second relates to how it is organized. The third relates to how it operates. An existing tribal organization contemplating Section 501(c)(3) status must show how its organization and operation fit within this three-part scheme. An Indian tribe or community group that is considering forming a nonprofit Section 501(c)(3) entity should be aware of these tests well before the entity begins to operate so that the requirements are considered in planning how the entity will be run, including its fundraising strategy.

### Purpose Test

To pass the purpose test, a nonprofit must be organized and operated for an exempt purpose that benefits public, rather than private, interests.<sup>68</sup> Of the many exempt purposes, charity is probably given the broadest definition. Under this definition, a tribal museum, a program that provides meals to low-income tribal elders and an organization that maintains tribal buildings or landmarks would all potentially qualify as charitable organizations.

Other definitions are also sufficiently broad to encompass a wide variety of activities. For example, IRS regulations define educational organizations as entities that train or instruct individuals on how to improve or develop their capabilities or inform the public on sub-

<sup>67</sup> Although the IRC does not explicitly treat Indian tribal governments as governmental units for purposes of excluding them from private foundation classification, the Internal Revenue Manual reflects the IRS position that Indian tribal governments are treated as states for § 509(a)(1) purposes. Internal Revenue Manual, *Private Foundations Handbook* (7752), § 260.

<sup>68</sup> Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

jects that are useful for individuals and/or beneficial to their community.<sup>69</sup> Under this definition, educational organizations would include almost all schools, museums and zoos, as well as organizations designed to educate persons on tribal history, traditions and language.

Although the regulations do not define religious organizations, the IRS and the courts have developed broad and inclusive definitions. Under these definitions, Native American religious organizations qualify for Section 501(c)(3) status on the same basis as other religions. As another example, a scientific organization is defined as an entity that performs scientific research in the public interest.<sup>70</sup> An organization of American Indian doctors devoted to exploring the medicinal properties of plants used in traditional healing methods may qualify as a scientific organization.

### Organizational Test

Any organization that seeks 501(c)(3) status must draft governing documents that conform to the requirements of the organizational test. If the organization is to be formed as a corporation, it must have articles of incorporation and bylaws. If it is to be an unincorporated association or trust, it must have either articles of organization in the form of a constitution, or a trust declaration or agreement.

In general, governing documents state the organization's purpose, the nature of its governing board, the required qualifications for board members and procedures for dissolving the organization. Such documents should also include language that conforms to provisions of federal law (and any applicable state or tribal law) that contain prohibitions on certain purposes or activities, or withhold or deny authority to engage in certain activities. The organizational test requires that governing instruments:

- limit the organization's purposes to one or more of the exempt purposes generally recognized as charitable,<sup>71</sup> and

- specify that, upon dissolution and under state or governing law, or under its governing instrument, the organization's assets be distributed for an exempt purpose, to a governmental body for public purposes or to another Section 501(c)(3) organization that will use the assets for exempt purposes.

Persons charged with drafting an organization's governing documents should be aware that state or tribal law may provide certain default provisions—provisions that apply as a matter of law if a governing instrument fails to address appropriate areas—and that these default provisions may not be consistent with tribal policy.

Once governing documents have been prepared, other initial necessary and legal organizational steps must be completed.<sup>72</sup>

### Operational Test

A 501(c)(3) organization must be operated for a public, rather than a private, purpose. The operational test measures compliance with this requirement. To pass the operational test, an organization must be operated exclusively for one or more exempt purposes. It can satisfy this test if its primary activities are directed toward its exempt purposes. The operational test also requires that the organization not distribute its earnings to private shareholders or individuals and that the organization not engage in prohibited legislative or political activities.

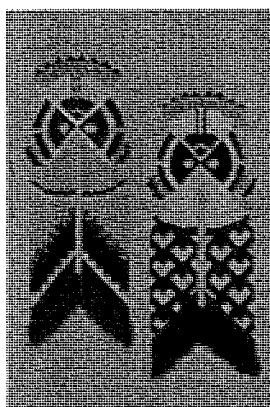
In addition, if an organization operates an unrelated business, that business may be subject to the unrelated business income tax (UBIT). If this unrelated activity is "substantial" and becomes a primary purpose of the organization, it may cause the organization to fail the operational test and lose recognition of its exempt status. A 501(c)(3) organization is also limited in how

<sup>69</sup> Treas. Reg. § 1.501(c)(3)-1(d)(3).

<sup>70</sup> Treas. Reg. § 1.501(c)(3)-1(d)(5).

<sup>71</sup> Treas. Reg. § 1.501(c)(3)-1(b)(1)(a).

<sup>72</sup> See Chapter 5 for a discussion of governance documents and issues.



**T**he Navajo Partnership for Housing, Inc. (NPH) is a Section 501(c)(3) public charity that provides information and services to Navajo community members interested in private home financing. Founded in 1996, NPH is incorporated under Navajo law. The organization's goals include educating the Navajo community about opportunities for federally guaranteed private home loans.

In particular, NPH conducts home buyer education courses designed to help community members assess family finances and home ownership readiness. In addition, it provides information on how to complete the loan application process and post-purchase issues such as good neighbor relations, home maintenance and dealing with changes in the family budget.

Persons who complete the course receive a home buyer preparation certificate.

NPH also provides loans for down payments and closing costs associated with home purchases. The organization works with various facilitators in the home ownership process, including mortgage lenders and contractors, provides assistance with home rehabilitation, and assists chapters (local governmental units) of the Navajo Nation in developing subdivisions.<sup>73</sup>

much lobbying it can undertake and is strictly prohibited from undertaking any activities associated with a political campaign.<sup>74</sup>

### Classification by Funding Sources

Once the IRS determines that an organization meets the purpose, organizational and operational tests for a charitable entity, it determines whether the organization is a public charity or a private foundation—a decision that is usually based on the organization's funding sources. In general, to obtain public charity status, an organization must receive donations from a wide variety of public sources. Three kinds of entities can obtain public charity status:

- publicly supported charities,
- gross receipts charities, and
- supporting organizations.

Each of these entities must show a level of public participation that the IRS recognizes as sufficient to

justify less extensive regulation than that which governs private foundations. As this description suggests, organizations that are funded by a single individual, a family or a company are usually defined as private foundations.

Publicly Supported Charities (Section 509(a)(1))

Organizations seeking classification as a Section 509(a)(1) publicly supported organization have two means available for passing the "public support" test:

- the mechanical test, and
- the facts and circumstances test.

### Mechanical Test

To pass the mechanical test, more than one-third of an organization's total support must come from a governmental unit, from contributions made directly or indirectly by the general public, or from a combination of these sources.<sup>75</sup> The percentage of public support is calculated by comparing the amount of public support to the total amount of support, including public support,

<sup>73</sup> Source: Material supplied by the Navajo Partnership for Housing, Inc.

<sup>74</sup> See Chapter 5 for a further discussion of UBIT and of this limitation.

<sup>75</sup> IRC § 170(b)(1)(A)(vi); Treas. Reg. §1.170A-9(e)(2).

investment income and other revenue. To ensure that public support is broad-based, the amount of support from one person that will count as "public support" is capped. Specifically, public support cannot include funds that come from any one person to the extent that those funds constitute more than 2 percent of the total contributions received by the organization. For example, if a person contributes \$25,000 to a public charity whose total support is \$1 million, the contribution would exceed the 2 percent limitation of \$20,000. As a result, the charity could not include the excess \$5,000 in the calculation of its public support. Government support generally is not subject to this 2 percent cap, nor is support from most publicly supported organizations.

Public support is calculated over a four-year period. The amount of eligible public support received in each of the prior four years (excluding the current tax year) is aggregated and compared with the total amount of support received for the same four years (excluding the current tax year). If the organization is able to show that

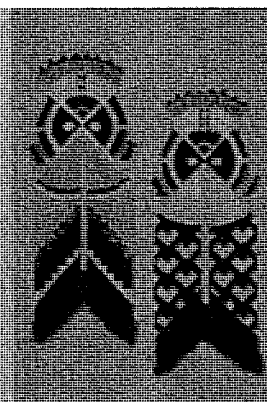
the aggregate amount of public support received in the previous four years (excluding the current tax year) meets the public support requirement of 33 1/3 percent of total support, then the organization is a public charity for the current tax year plus the following tax year.<sup>76</sup> The American Indian College Fund is an example of an organization that qualifies as a public charity as a result of the mechanical test.

An important point for Native American communities is that the tax code defines governmental support as support from states, possessions of the United States, political subdivisions of a state or possession, the United States or the District of Columbia.<sup>77</sup> Because tribal governments are not included in this statutory definition, it can be argued that support from tribal entities that exceeds 2 percent of the charity's total support during the relevant period cannot be included as "public support." This result is inconsistent with federal tax policy as it generally applies to Indian tribal governments. (This issue is referred to as the "2 percent question" throughout this manual.)

**F**irst Nations Development Institute is a Section 501(c)(2) public charity incorporated in Fredericksburg, Virginia. Founded in 1980, its goal is to provide Indian tribes and individual Native Americans with the resources needed to help build sustainable reservation economies. The institute focuses on projects that are reform-minded, culturally suitable and economically doable. For instance,

the institute's Oweesta Program assists Indian tribes in various aspects of lending and capital management. In particular, the program works with tribes to establish lending programs, manage assets and develop relationships with banks and financial institutions.

The institute's Eagle Staff Fund makes grants and provides technical assistance for a wide range of projects. For example, a working capital grant to the Porcupine Clinic Health Board in South Dakota helped the clinic redesign financial procedures and led to a direct mail fundraising campaign. The fundraising campaign established an endowment that produces income for the Clinic's activities.<sup>78</sup>



<sup>76</sup> Treas. Reg. §1.509(A)-3(c).

<sup>77</sup> IRC § 170(b)(1)(A)(vi), cross-referencing § 170(c)(1). See also IRC § 509(a)(2) flush language. Cf. Internal Revenue Manual, *Private Foundations Handbook* (7752) § 260 (for purposes of § 509(a)(1), Indian tribal governments should be treated like other governmental units).

<sup>78</sup> Source: Material supplied by First Nations Development Institute; and *The Ford Foundation Report*, Spring 1997, Vol. 28, No. 2, p. 12.

## Facts and Circumstances Test

If a Section 509(a)(1) charity fails the mechanical test, it may still qualify for public charitable status under the facts and circumstances test, which requires that it:

- receive at least 10 percent of its normal support from governmental and/or public sources,
- conduct fundraising programs on a regular basis, seeking funds from the general public, governments or other public charities, and
- demonstrate the presence of other relevant facts and circumstances, including the amount of governmental and public support, the extent to which the organization's governing board is representative of the public,<sup>79</sup> whether the organization makes its facilities or programs available to the public, the nature of its membership fees, and whether persons with common interests are likely to become involved with the organization.<sup>80</sup>

## Gross Receipts Test (Section 509(a)(2))

To qualify under the gross receipts test, an organization must receive more than one-third of its support from:

- gifts, grants, contributions from the general public (including grantmaking organizations and governmental entities) or membership fees, and
- gross receipts from admissions, sales of merchandise, performance of services or furnishing facilities for an activity that is not an unrelated trade or business.

Organizations that provide services for a fee—a Native American museum, for instance—could seek to establish eligibility by satisfying the gross receipts category.

This definition of “support” for purposes of the gross receipts test is broader than that for Section

509(a)(1) purposes in that under Section 509(a)(2), support includes income derived from activities directly related to an organization's exempt function (gross receipts). In this respect, the Section 509(a)(2) concept of a public charity is broader than that of Section 509(a)(1). This concept is, however, narrowed somewhat by the limits that Section 509(a)(2) imposes on the amount of *contributions* and *gross receipts* derived from a single person or entity that qualify as public support under the one-third test of Section 509(a)(2):

- Aggregate *contributions* received from a single person or entity—other than governmental units or Section 509(a)(1) public charities—in excess of \$5,000 are *totally* excluded from public support if such contributions exceed 2 percent of the total contributions and bequests received by the organization since its inception.<sup>81</sup>
- Gross *receipts* from related activities derived from a single person, or from any bureau or similar agency of a governmental unit, are includible as public support only to the extent that such receipts do not exceed the greater of \$5,000 or 1 percent of an organization's total support in a given tax year.<sup>82</sup>

The same definition of *governmental unit*—state, local, federal, *but not* (apparently) tribal governments—applies for these purposes.

An organization seeking to qualify as a public charity under Section 509(a)(2) must also pass the investment income test, which specifies that no more than one-third of annual support can be derived from the sum of gross investment income (income from interest, dividends, payments on securities, loans, rents and royalties) and the difference between any unrelated business taxable income and the amount of unrelated business income tax imposed on such activity.<sup>83</sup> In contrast, a publicly supported charity that meets the mechanical or facts and circumstances test can accumulate investment income exceeding this ceiling.

<sup>79</sup> One way an organization can maximize the breadth of its fundraising base is by selecting a board that represents a wide variety of interests.

<sup>80</sup> Treas. Reg. § 1.170A-9(e)(3).

<sup>81</sup> IRC §§ 509(a)(2), 4946, 507(d)(2); Treas. Reg. § 1.509(a)-3(a)(2)(ii).

<sup>82</sup> Treas. Reg. § 1.509(a)-3(b).

<sup>83</sup> IRC § 509(a)(2)(B)(i) and (ii).

### Supporting Organization Test (Section 509(a)(3))

If a charitable organization has difficulty satisfying the technical "public support" tests of Sections 509(a)(1) or 509(a)(2), it might seek public charity status under Section 509(a)(3).

Section 509(a)(3) public charity status differs from both Section 509(a)(1) and Section 509(a)(2) in that it does not require organizations to conduct a particular kind of activity or to receive financial support from the general public. Instead, Section 509(a)(3) describes organizations that have established certain relationships in support of Section 509(a)(1) or Section 509(a)(2) organizations.

To qualify as a Section 509(a)(3) public charity, an organization must meet each of the following three requirements:

- The organization must be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified Section 509(a)(1) or Section 509(a)(2) organizations (domestic or foreign).
- The organization must be operated, supervised or controlled by or in connection with one or more Section 509(a)(1) or Section 509(a)(2) organizations.
- The organization must not be controlled directly or indirectly by "disqualified persons," who include substantial contributors, their families and others.<sup>84</sup>

Foundations that support the activities of a governmental unit are frequently organized to meet the "supporting organization" test of Section 509(a)(3).

Governmental units listed in Section 170(c)(1)—states,

U.S. possessions, political subdivisions of states and possessions, the United States and the District of Columbia—are automatically treated as public charities under Sections 509(a)(1) and 170(b)(1)(A)(v). Thus, if properly structured, a supporting entity formed by and accountable to such a governmental unit may also achieve public charity status. Although Indian tribal governments are not specifically listed in Section 170(c)(1), the IRS has informally indicated that they will be treated as such for Section 509(a) purposes.<sup>85</sup>

### COMMUNITY FOUNDATIONS: A SPECIAL KIND OF PUBLICLY SUPPORTED CHARITY

A community foundation is one specific type of publicly-supported charitable organization and is designed to attract contributions for the benefit of a particular community or area. The governing bodies of community foundations are composed of representatives of the community or area. Donors to community foundations have a variety of options in deciding what happens to the money they donate. Although they cannot specify an individual recipient, they can specify whether the funds are to be maintained in a separate named fund or combined with other donations, the kinds of things the funds will support, and whether the funds are maintained as an endowment or spent down. The separate trusts or funds within a community foundation are ultimately subject to control by the governing body.<sup>86</sup> Despite being an aggregation of trusts or funds, the component funds that make up a community foundation are treated as a single entity for tax purposes.<sup>87</sup>

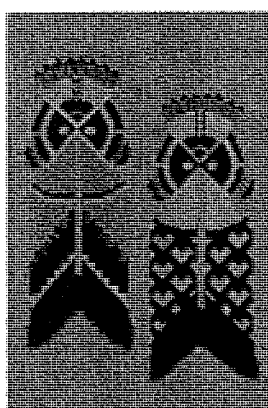
<sup>84</sup> IRC §509(a)(3)(A), (B), (C).

<sup>85</sup> Internal Revenue Manual, *Private Foundation Handbook* (7752) § 260.

<sup>86</sup> Treas. Reg. § 1.170A-9(e)(10). Based on federal tax standards, the Council on Foundations has developed the following definition: "A community foundation is a tax-exempt not-for-profit, autonomous, publicly supported, philanthropic institution comprised primarily of permanent funds endowed by many separate donors for the long-term benefit of the residents of a defined geographic area." For a comprehensive treatment of the law governing community foundations, see Christopher R. Hoyt, *Legal Compendium for Community Foundations* (1996), available from the Council on Foundations.

<sup>87</sup> Treas. Reg. § 1.170A-9(e)(11)(i).





In 1993, the Montana Community Foundation partnered with the Ford Foundation's Rural Initiative to fund what is now the Beacon Communities Projects. One of the three Beacon communities in Montana is centered in Browning, the cultural and economic center of the Blackfeet Reservation. Under the terms of the Montana Community Foundation's grant, each Beacon community is eligible for technical assistance and up to \$137,000 for its community programs, if it creates its own endowment fund. The original aim of the Browning development project was to establish a regional landfill and recycling center. The Blackfeet Nation's Recycling Center is now rising at full speed and expanding its work into other communities. The Recycling Task Force is also using Montana Community Foundation funds to expand educational opportunities that encourage recycling. An auction with art donated by Native American artists and an annual Harvest Moon Ball have helped to build the Blackfeet Community Endowment Fund. Its purpose has been broadened to include a multifaceted community revitalization project. As of late 1997, the Blackfeet Endowment Fund had swelled to \$47,000.<sup>88</sup>

The four basic types of funds maintained in community foundations are as follows:

- General purpose fund. A fund established without specific restrictions on how or for what purposes it can be used; grants from these types of funds are made at the sole discretion of the board of the community foundation.
- Field-of-interest funds. A fund in which the donor names causes, geographic areas or other fields of interest for which the fund is to be used.
- Donor-advised funds. A fund that provides a way for donors to influence—but not control—how such a charity applies its charitable contributions. With a donor-advised fund, the donor (or a committee designated by the donor) can recommend that specific charitable organizations receive grants from the fund. In the end, however, grantmaking decisions always rest with the governing body of the charitable organization

charged with administering the fund.<sup>89</sup>

- Designated fund. A fund that can only be used to provide support to entities named by the donor.

### Private Foundations

The line of demarcation between private foundations and public charities was clearly drawn with passage of the 1969 Tax Reform Act. Within the philanthropic community, the term private foundation normally suggests an organization with three distinct features:

- it has one source of funding, usually one person, one family or one corporation,
- the organization does not engage in direct charitable activities but instead makes grants to other charities to perform the service or activity, and
- the funds available for grants and the necessary administrative expenses come from endowment income.

<sup>88</sup> Sources: Marjane Ambler, "Indians Giving: The New Philanthropy in Indian Country," *Tribal College* (Winter 1994) pp. 14, 21; Donald Snow, "Strong Foundations," *Chronicle of Community* (Spring 1997), pp. 16–21; and materials supplied by the Montana Community Foundation.

<sup>89</sup> For more information on donor-advised funds, see Edward Jay Beckwith, *et al.*, *Establishing an Advised Fund Program: A Summary of Legal and Management Issues*, available from the Council on Foundations. Donor-advised funds are used regularly by public charities; because it is not clear whether a donor-advised fund would share in an Indian tribe's tax-immunity, it might be advisable to seek a ruling from the IRS prior to implementing a donor-advised fund as part of a tribal charitable giving program.



Beyond that commonality, private foundations are established as independent, company or corporate, conduit or pass-through, operating and pooled common fund entities.

An Indian tribe may sometimes prefer private foundation status because it:

- Eliminates the need for maintaining an ongoing public fundraising program. The foundation can instead rely on funding by the Indian tribe or a tribal enterprise without having to seek additional public support to meet the requirements of IRC Sections 509(a)(1) or 509(a)(2).
- Enhances the operation and reputation of the tribal or tribal enterprise charity by virtue of compliance with reporting and operating rules. Although legal and other professional costs incurred in complying with the rules can be high, the rules can prevent the charity from entering into transactions that divert it from its charitable purposes.
- Fosters accountability to the general public. Compliance with reporting requirements ensures public accountability, a critical factor in gaining financial support from the public.

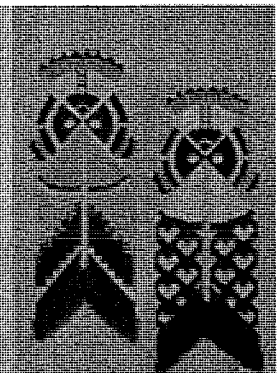
### Independent Foundations

The independent foundation is the most common type of private foundation. In 1997, some 40,000 independent foundations operated nationwide with assets ranging in size from less than \$10,000 to more than \$10 billion. Most, but not all, have endowments and their funds usually are obtained from a single source. These foundations are governed by their own trustees or board of directors. Although independent foundations are not constrained legally from operating their own charitable activities or services, they use the bulk of their annual budgets for grants to other charitable organizations, which in turn provide services or support to the public. Thus, most independent private foundations are classified as "nonoperating" foundations. Support may come from a person or family.

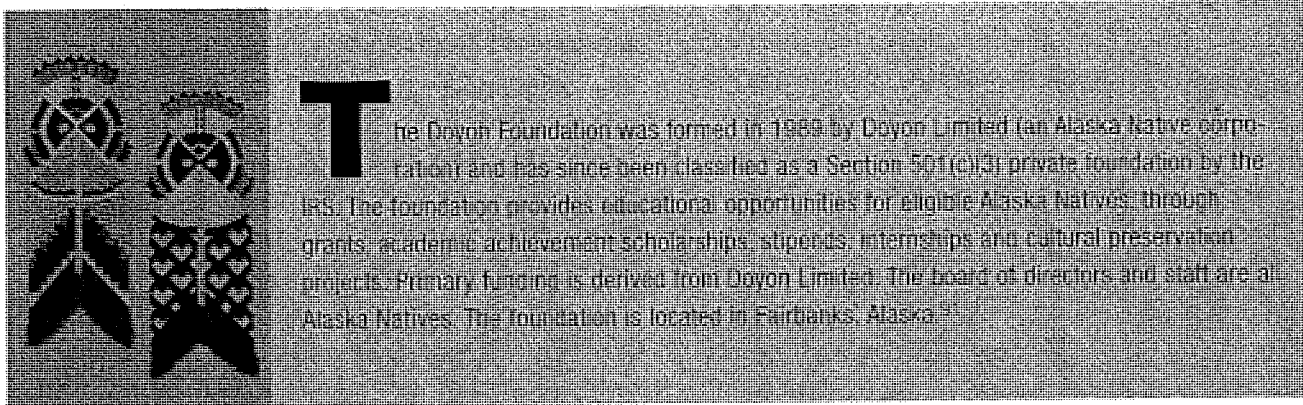
### Company or Corporate Foundations

In virtually every respect, the company or corporate foundation is a private, nonoperating foundation subject to the same rules that apply to an independent foundation. The source of funds for this type of foundation is, however, a for-profit company. Technically, the corporate foundation is a separate legal entity (usually a non-profit corporation). But despite its separate legal status, the corporate foundation is usually closely tied to the corporation that provides its funding.

In 1991, the Eastern Band of Cherokee Indians formed a donor advised fund in the North Carolina Community Foundation (NCCF), headquartered in Raleigh, North Carolina. As an unincorporated legal entity, this advisory board shares the same charitable tax status under Section 501(c)(3) as NCCF. The purpose of the Eastern Band's board is to advise NCCF on how charitable funds should be spent within the Qualla Indian Boundary—the tribe's historic lands in and around Cherokee, North Carolina. Located in Cherokee, North Carolina, the Eastern Band's unrestricted endowment began making grants in 1996. To date, it has funded three projects.<sup>90</sup>



<sup>90</sup> Sources: Material supplied by the Eastern Band of the Cherokee Nation and the North Carolina Community Foundation.



**T**he Doyon Foundation was formed in 1989 by Doyon Limited (an Alaska Native corporation) and has since been classified as a Section 501(c)(3) private foundation by the IRS. The foundation provides educational opportunities for eligible Alaska Natives through grants, academic achievement scholarships, stipends, internships and cultural preservation projects. Primary funding is derived from Doyon Limited. The board of directors and staff are all Alaska Natives. The foundation is located in Fairbanks, Alaska.

Although most company foundations have an endowment, it is usually small—perhaps two or three times the annual grant budget. For the most part, grants made by a company foundation are derived from charitable contributions received from the parent company in the same year. The funds simply pass through. By building up a small endowment in the foundation, the company can maintain a reserve for low-profit years and thus keep the level of its contributions budget steady even if the profit/loss picture fluctuates.

The board of directors of a company foundation is usually composed of corporate officials and generally makes all decisions about grant recipients. Occasionally, the board will include individuals with no affiliation to the sponsoring corporation and sometimes grant decisions are made by local company officials in different parts of the country, according to agreed-upon procedures. Grantmaking by company foundations tends to be in fields related to corporate activities or in communities where the corporation operates. It is also common for companies to maintain a separate corporate contributions budget that makes grants directly to charities in addition to the grants made through the foundation.

### **Conduit or Pass-Through Foundations**

Conduit foundations are private, nonoperating foundations. They are subject to all the rules and regulations that govern private foundations. Donors often create this type of foundation while they are living so that they can create an entity that will be ready to accept a

larger infusion of funds at their death. Although this is a private foundation, the donor is able to take advantage of more liberal limitations on charitable deductions afforded this philanthropic form. All contributions to a conduit foundation must flow through or pass through within two and one-half months after the end of the tax year in which the gifts were made. Private foundations can elect to be, or not to be, a conduit foundation on a yearly basis.

### **Operating Foundations**

Operating foundations carry out their own charitable purposes. Although they are subject to nearly all of the restrictions and reporting requirements of other private foundations, they are subject to more liberal charitable deduction rules. As such, they are similar to conduit foundations. To qualify as an operating foundation, a foundation must spend substantially all (85 percent) of its net investment income directly for the active conduct of its own exempt activities (as opposed to making grants).

Some operating foundations make a limited number of grants, but most operate museums, libraries, nursing homes, orphanages, research institutes or historic preservation parks. Most often, operating foundations are funded through an endowment created by the original donor; however, it is also possible for an operating foundation to have no endowment and receive its operating funds through annual contributions from one donor or a small number of donors.

<sup>91</sup> Source: NAP Survey, *supra* note 3 at p. 26; and material supplied by the Doyon Foundation.

### **Pooled Common Fund or Donor-Directed Depository**

Although rarely used, the pooled common fund or donor-directed depository is another available option. This type of fund resembles a supporting organization (the Section 509(a)(3) public charity) except that the donor retains much more control over the eventual disposition of the funds. Because of this control, the organization is classified as a private foundation and is subject to the regulations that govern that type of entity. Despite private foundation status, donors to pooled common funds qualify for the most favorable rules for any charitable deductions.

### **OPERATING RESTRICTIONS ON CHARITIES**

All Section 501(c)(3) organizations are subject to general operational restrictions. Some are designed to ensure that the charity serves public, not private, interests; others are designed to curb political activity and prevent unfair competition with commercial enterprises.

#### **Private Inurement and Private Benefit**

One of the most basic operational restrictions for public charities is the prohibition of operating in such a way that an "insider" with a personal and private interest in the organization receives excess benefits. This is called *private inurement*. It occurs when an individual receives more than is reasonable—in terms of payments or other benefits—from the organization. For example, an executive director who receives excessive compensation might cause the organization to violate the prohibition on private inurement.

To avoid private inurement, a public charity must ensure that any compensation or other consideration—including loans, sales or services—provided to persons who can influence the organization is reasonable. To help prevent situations in which private inurement might occur, organizations often adopt a conflict-of-interest policy in their bylaws or through a board resolution. Careful documentation and independent appraisals of the value of transactions with officers and

directors can also provide support for the reasonableness of a transaction if the IRS raises questions during an audit.

It is also important to understand the difference between private inurement and private benefit. The former is concerned with "insiders" who control the organization. The latter is concerned with anyone who benefits from, or is served by, the organization. Private benefit occurs when an organization uses its resources to benefit private interests—for example, excessive payments to commercial vendors—at the expense of the organization's charitable program. An organization that provides services to a small or exclusive group of people could also be viewed as conferring private benefit.

#### **Lobbying and Political Campaigning**

A tribal charity that intends to influence legislation or public policy must work within federal restrictions on political campaigning and lobbying. As a general rule, lobbying by public charities is restricted to an amount that is "insubstantial" relative to the organization's overall charitable activities, but political campaigning is absolutely prohibited. An organization that engages in legislative or excessive political activities is in jeopardy of violating the operational test, which places its tax-exempt status at risk.

To qualify for tax-exempt status, Section 501(c)(3) entities cannot devote a substantial part of their activities to carrying "on propaganda, or otherwise attempt[ing], to influence legislation...."<sup>92</sup> As this suggests, a public charity can engage in insubstantial lobbying activities without violating this rule. The regulations further state that activities designed to influence legislation include direct lobbying and grassroots lobbying—urging the public to contact their elected representatives to support or oppose legislation.<sup>93</sup> Legislation includes actions by the Congress, a state legislature or any "local council or similar governing body," as well as legislation initiated through public referendums, constitutional amendments or any "similar procedure."<sup>94</sup>

<sup>92</sup> IRC § 501(c)(3).

<sup>93</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii)(a) & (b).

<sup>94</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii)(b).

Under the rules that relate to political campaigning, a tax-exempt public charity or private foundation is absolutely prohibited from using any of its funds or resources to support or oppose any candidate for public office.<sup>95</sup> Specifically, Section 501(c)(3) organizations must not participate in, or intervene in (including publishing or distributing statements), any political campaign on behalf of (or in opposition to) any candidate for public office.<sup>96</sup> A public office includes a national, state or local office.<sup>97</sup>

The prohibition against involvement in political campaigns is *absolute*; any violation of that prohibition jeopardizes tax-exempt status. Furthermore, a public charity must pay a fine of 10 percent of each political expenditure it made if it violates this provision.<sup>98</sup> A political expenditure is an amount paid or cost incurred with respect to the political campaign of a candidate for public office. Managers of organizations can also be individually liable for an additional amount equal to 2.5 percent of the political expenditure.<sup>99</sup>

Political expenditures must be corrected when discovered. To correct a political expenditure, an organization must attempt to recover the expenditure, establish procedures to prevent further expenditures and take additional corrective action as prescribed by regulation if the full amount of the expenditure cannot be recov-

ered.<sup>100</sup> If the organization fails to "correct" its political expenditures within a defined period, it must pay an additional tax equal to the amount of the political expenditure.

IRC Section 501(h) includes elective rules that can help public charities avoid problems with lobbying expenditures. These rules permit certain public charities to have special expenditure ceilings set on the amounts they use for lobbying. If the ceilings are exceeded, the tax described in Section 4911 applies to the amount of the excess. Some exceptions apply to the activities of public charities making the Section 501(h) election that would otherwise constitute lobbying activities.<sup>101</sup> Tribal governments are treated as states for purposes of the Section 4911 tax; thus, any funds an organization uses to lobby a tribal government are included when calculating total lobbying expenditures.<sup>102</sup>

Specific taxes also apply to the lobbying and political activities of private foundations. The IRS imposes a tax on expenditures by private foundations that are associated with carrying on propaganda, attempting to influence legislation, influencing public elections or carrying on voter registration drives.<sup>103</sup> A narrow exception for nonpartisan and self-defensive activities exists.<sup>104</sup> Because the IRC treats tribal governments as states for purposes of Sections 4940-4948, to the extent

<sup>95</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii). The regulation defines a candidate for public office as "an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state, or local." *Id.* Although this does not explicitly reference a candidate for tribal office, it is unlikely that the IRS would treat campaigning for or against a candidate for tribal office as an exception to the prohibition against political campaigning.

<sup>96</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).

<sup>97</sup> *Id.*

<sup>98</sup> IRC § 4955 (a)(1) & (2).

<sup>99</sup> IRC § 4955(a)(2).

<sup>100</sup> The excise tax on political expenditures applies to any § 501(c)(3) organization, whether it is a public charity or a private foundation. If the tax is imposed on a private foundation, however, the expenditure is not considered a taxable one for purposes of the excise tax under § 4945.

<sup>101</sup> A public charity making the election under § 501(h) can make appearances before or to communicate with a legislative body if a decision of that legislative body might affect its existence, its powers and duties, its tax-exempt status or the deduction of contributions it receives. IRC § 4911(d)(2)(C). Other exceptions are delineated in IRC § 4911(d)(2)(A), (B), (D) and (E).

<sup>102</sup> Under IRC § 7871(a)(7)(A) tribal governments are treated as states for purposes of the tax on public charities for excess expenditures to influence legislation (a tax that applies to public charities who have elected to make lobbying expenditures within certain limits as described in IRC § 501(h)). The legislative history to § 7871 states that, "legislation dealt with by Indian tribal governments and subdivisions is within the purview of the tax... [under § 4911] in the same manner as legislation dealt with by States and political subdivisions." S. Rep. No. 646, 97th Cong. 2nd Sess. 15-16 (1982), *reprinted* in 1982 U.S.C.A.A.N 4580, 4593-4594.

<sup>103</sup> IRC § 4945(d)(1) & (2). These subsections further refine the restrictions on lobbying and exclude certain expenditures associated with nonpartisan activities, including voter registration drives under certain circumstances.

<sup>104</sup> Treas. Reg. § 53.4945(e)-(f).

that a private foundation funds lobbying activities directed at tribal governments, the foundation may be subject to the excise tax on taxable expenditures.<sup>105</sup>

If a private foundation makes a grant to a public charity and the charity uses the grant for lobbying or legislative purposes, the grantmaking foundation is not subject to the taxable expenditure rules provided that it did not earmark the grant for particular lobbying purposes.<sup>106</sup>

## **PENALTIES ON PRIVATE FOUNDATIONS AND PUBLIC CHARITIES**

Although private foundations and public charities operate under some of the same restrictions, penalties for not complying with these regulations are specific to each type of charitable organization. The following are descriptions of some of these penalties.

### **Penalties on Private Foundations**

Before enactment of the 1969 Tax Reform Act, a private individual (or family) could create a foundation, obtain a charitable tax deduction for making gifts to that foundation and then control the foundation in a private way with little public accountability. Beyond the requirement that the foundation be organized and operated exclusively for charitable purposes and file an annual tax return, the rules and restrictions applicable to private foundations were not very strict. To regulate the activities of private foundations more closely, Congress established a number of limits on their operations. Below is a brief description of those rules.<sup>107</sup>

### **Two Percent Excise Tax on Investment Income (Section 4940)**

Every private foundation must pay a 2 percent annual excise tax on its net investment income—its gross investment income (including dividends, interest and capital gains) less expenses attributable to producing that income. A foundation that meets certain distribution requirements may qualify for a lower 1 percent tax rate. Estimated tax payments must be paid on a quarterly basis.

### **Penalty Tax on Acts of Self-Dealing (Section 4941)**

Acts of self-dealing—sales of property, loans and the provision of goods, services or facilities between a foundation and so-called disqualified persons (trustees, directors, foundation managers, substantial contributors, government officials and family members or entities related to these persons)—are prohibited.<sup>108</sup> The penalty tax on self-dealing applies to both direct and indirect transactions, even if the terms of the transaction are favorable to the foundation, and the tax rate can be as high as 200 percent of the amount involved. This prohibition does not, however, preclude paying reasonable compensation to a disqualified person for the personal services needed to carry out a private foundation's exempt purposes. This exception permits payments to trustees and certain other professional service providers with close ties to the foundation.

<sup>105</sup> The legislative history accompanying the Indian Tribal Governmental Tax Status Act states that "the restrictions on private foundations influencing legislation similarly are to apply to tribal legislation in the same manner as those restrictions now apply to State legislation." S. Rep. No. 646, 97th Cong., 2nd Sess. at 15-16, (1982), *reprinted in* 1982 U.S.C.A.N. 4580, 4593-4594.

<sup>106</sup> Treas. Reg. § 53.4945-2(a)(6).

<sup>107</sup> In addition to the IRC and regulations, the private foundation organization rules have spawned numerous IRS administrative rulings, procedures and explanations. See generally Freeman, D., and Council on Foundations, *Handbook on Private Foundations* (rev. ed. 1991, Foundation Center).

<sup>108</sup> The legislative history of § 7871 indicates that Congress intended to apply restrictions on self-dealing to transactions between private foundations and Indian tribal officials. S. Rep. No. 646, *supra* note 105 at 16.

### **Penalty Tax on Failure to Meet Minimum Charitable Payout (Section 4942)**

Failure to spend annual qualifying distributions equal to 5 percent of the foundation's assets, with certain adjustments, results in a tax. Qualifying distributions must be made for charitable purposes under IRC Sections 170(c)(1) or (2)(B), which encompass grants made to a state, a political subdivision or a Section 501(c)(3) organization.<sup>109</sup> Section 7871 specifies that a tribal government is treated as a state for purposes of both Section 170 and the private foundation excise tax rules (including Section 4942).<sup>110</sup> Thus, grants made to an Indian tribe, or a political subdivision or integral part thereof, should be treated as qualifying distributions. The IRS has not, however, formally concurred in this result. Grants made to an organization controlled by the private foundation or its officers, managers and other disqualified persons are not included as qualifying distributions unless certain additional requirements are met.<sup>111</sup> The required distribution for a given year is based on the valuation of the foundation's assets for that year; a foundation has until the end of the following tax year to make the required distribution. If a private foundation fails to make its required amount of qualifying distributions for the year, it is subject to a tax equal to 15 percent of the shortfall.

### **Penalty Tax on Excess Business Holdings (Section 4943)**

Private foundations are prohibited from controlling a for-profit business. A private foundation's holdings in a business are for the most part limited to 20 percent of all voting stock. This limit is further reduced by the percentage of voting stock held by disqualified persons; however, the limit can rise to 35 percent if the foundation and all disqualified persons hold no more than 35 percent of voting stock and nondisqualified persons are

in effective control of the enterprise. Failure to divest holdings in excess of these limits can lead to an excise tax of up to 200 percent of the value of the private foundation's excess business holdings. If a private foundation receives the excess business holdings not through a purchase, but as a contribution or bequest, the foundation has up to five years to dispose of the excess holdings before the excise tax applies.

### **Tax on Jeopardy Investments (Section 4944)**

Investments that could jeopardize the foundation's ability to carry out its exempt purposes are prohibited. The law, however, does recognize an exception to the excise tax on jeopardy investments for investments whose primary purpose is not the production of income or the appreciation of property, but the accomplishment of an exempt purpose. These investments are known as "program-related" investments. If the IRS determines that a foundation has made jeopardy investments, both the foundation and the responsible foundation manager are subject to a range of excise taxes beginning at 5 percent of the investment.

### **Tax on Taxable Expenditures (Section 4945)**

Private foundations that make donations or expenditures that are considered "taxable expenditures" are subject to a penalty tax.<sup>112</sup> Taxable expenditures include funds paid for lobbying, electioneering, voter registration and certain grants to individuals for travel or study. Such expenditures also include grants to organizations unless the organization qualifies as a public charity under Section 509(a) or the foundation exercises expenditure responsibility.

IRS regulations under Section 4945 treat various types of governmental units as public charities for purposes of Section 4945—state, local, federal and even foreign governments and international organizations.<sup>113</sup>

<sup>109</sup> Treas. Reg. § 53.4942(a)-3(a)(2)(i).

<sup>110</sup> See § 7871(a)(7)(B) (treating a Tribe as a state for purposes of IRC "Subchapter A of Chapter 42," which includes §§ 4940-4948).

<sup>111</sup> Treas. Reg. § 53.4942(a)-3(a)(2)(i)(b).

<sup>112</sup> IRC § 4945.

<sup>113</sup> Treas. Reg. § 53.4945-5(a)(3)(iii) & (5).

Promulgated in the 1970s (before the enactment of the Tribal Tax Status Act), these regulations do not refer to tribal governments. Section 7871 mandates that Indian tribes be treated like states for purposes of Section 4945. Thus, although the IRS has not formally ruled on this issue, it has taken the position that Indian tribal governments should be treated the same as state governments under Section 4945.<sup>114</sup> Accordingly, a grant to an Indian tribal government for a program within, for example, the Indian tribe's education department should not be treated as a taxable expenditure requiring the foundation to exercise expenditure responsibility over the grant.

### **Expenditure Responsibility**

Certain grants that might otherwise be classified as taxable expenditures are not treated as such if the donor exercises expenditure responsibility over them.<sup>115</sup> Expenditure responsibility is achieved if the private foundation makes all reasonable efforts and establishes adequate procedures to:

- ensure that a grant is used for its anticipated purposes,
- obtain reports from the donee on how the funds were actually spent, and
- report such donations to the Secretary of the Treasury.

To be in compliance with federal expenditure responsibility requirements, a private foundation should prepare or require:<sup>116</sup>

- a pre-grant inquiry into the potential donee,
- a written expenditure responsibility commitment signed by the grantee,

- reports from grantees and investigation by the grantor of delinquent reports and diversion of funds, and
- an annual status report concerning the grant by the private foundation on an attachment to Form 990-PF.

Expenditure responsibility rules allow private foundations to make grants to organizations that do not qualify as public charities, provided that such grants are for religious, charitable, scientific, literary, educational or similar purposes.<sup>117</sup> By exercising expenditure responsibility, a private foundation should be able to make a grant to a state-recognized tribal government for charitable purposes without creating a taxable expenditure.

Although the IRC does not explicitly treat a tribal government as a state for all Section 509 purposes, a private foundation should not be required to exercise expenditure responsibility for any grant it makes directly to a qualified Indian tribal government.<sup>118</sup> Grants to tribal governments or units not recognized as such under Section 7871, such as a state-recognized Indian tribe, may, however, trigger such a procedure. The expenditure responsibility rules may also come into play when a foundation makes a grant to a commercial enterprise in an economically depressed area.

### **Effect of Losing Private Foundation Status**

An organization whose private foundation status is terminated is subject to a Section 507 termination tax equal to the lesser of the following: the dollar value of the aggregate tax benefits resulting from its Section 501(c)(3) status, or the value of the foundation's net assets. If the terminating foundation selects the first

<sup>114</sup> Internal Revenue Manual, *Private Foundations Handbook* (7752) § 17(83) adopts the position that Indian tribal governments are treated as states (and hence like public charities) for IRC § 4945 purposes.<sup>115</sup> IRC § 4945(d)(4).

<sup>116</sup> Treas. Reg. § 53.4945-5.

<sup>117</sup> IRC § 4945(d)(5).

<sup>118</sup> See Internal Revenue Manual, *Private Foundations Handbook* (7752) § 17(83)(4) (stating the IRS position that Indian tribal governments should be treated like state governments for IRC § 4945 purposes). Under IRC § 7871, Indian tribal governments are treated as states for purposes of IRC §§ 4940-4948. Thus, grants to any entity that qualifies as an Indian tribal government (including political and integral parts thereof) should not require expenditure responsibility.

amount, it bears the burden of substantiating the value of such benefits from its inception as an organization. The termination tax can be avoided only if the private foundation distributes its assets to a public charity, including a state or local government. This provision is designed to prevent foundations from accumulating a corpus of tax deductible contributions and then converting to taxable or noncharitable tax-exempt status. The provision could, however, be construed to impede a tribal government from dissolving a tribal foundation and having foundation assets revert directly back to the Indian tribe.<sup>119</sup>

### Penalties for Public Charities

Public charities are also subject to IRC Section 4958, which imposes taxes as penalties on excess benefits provided to insiders. Under Section 4958, the IRS can penalize—without revoking tax-exempt status—violations of the private prohibition.<sup>120</sup> These sanctions are used to penalize organization managers for giving excess benefits to any person who is in a position to exercise substantial influence over the affairs of the organization (or a family member of such person).<sup>121</sup> Excess benefits are defined as:

- non-fair market-value transactions,
- unreasonable compensation, and
- certain revenue-sharing arrangements.

For example, a public charity that sells a piece of real property to one of its directors at less than full fair-market value is conferring an excess benefit. By contrast, under the Section 4941 rules on self-dealing, private foundations are subject to absolute prohibitions on certain transactions involving insiders, even if the transactions reflect fair-market value or work to the foundation's favor.

### State Law Penalties and Sanctions

A tribal public charity or private foundation that forms under state law is subject to the authority of the state attorney general who oversees charitable corporations and trusts. Under state nonprofit corporation and trust law, the attorney general usually has the authority to take legal action to prevent a charity from operating outside of the charitable purposes set forth in its articles of incorporation or similar documents. Some nonprofit corporation statutes even require that the attorney general take legal action if a citizen of the state presents evidence of such a violation. Under certain circumstances, a court can dissolve a charitable organization if it acts outside the parameters set by its charter. Such legal actions would obviously have significant implications for tribal sovereignty, especially if the charity were funded primarily with tribal assets.

### CHARITABLE CONTRIBUTIONS AND DEDUCTIONS

Most charitable organizations must raise funds to support their programs and activities. Individual and corporate donors generally prefer and expect that their donations will be deductible from their income taxes, whereas private foundations generally expect that their donations will constitute qualifying distributions, and not taxable expenditures. Public charities are concerned about donations for purposes of calculating public support. Grantseeking organizations should be aware of these expectations and must be able to answer donors' questions about the tax effects of their donations. Although general rules apply to answer these questions, there are also exceptions. In addition, rules for charitable deductions differ depending on the type of donee and donor and the nature of the charitable contribution.

<sup>119</sup> This apparently unintended result is due to the omission of a cross-reference to IRC § 507 in § 7871; it is possible, however, that the IRS would treat Tribes as states for purposes of § 507 because they are so treated for purposes of the private foundation excise taxes in §§ 4940–4948.

<sup>120</sup> See generally Nilles, Palmer and Peregrine "Complying with the New Intermediate Sanctions Law," pp. 245–253, *The Exempt Organization Tax Review*, Aug. 1996. These restrictions also apply to § 501(c)(4) social welfare organizations.

<sup>121</sup> The definition of "substantial influence" and "excess benefit" contains a five-year look-back rule, so that even a former director may not receive inappropriate benefits without penalty.



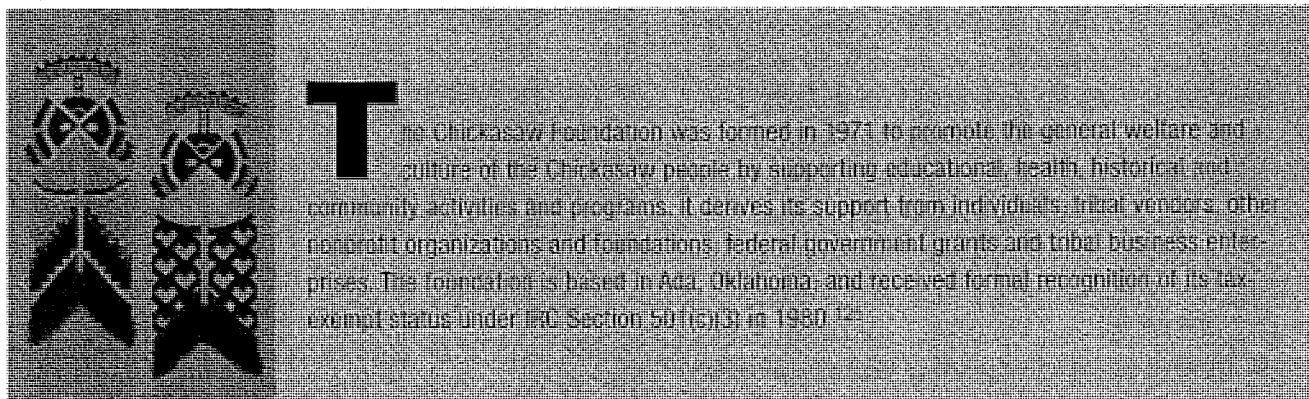
Individual donations to private foundations are generally—although not always—treated less favorably under the IRC; therefore, status as a public charity is often important in attracting donors.

Under the IRC, charitable contributions include contributions or gifts to or for the use of:

- governmental units, such as the United States, a state or an American Indian tribe,<sup>122</sup> provided that the governmental unit uses the contribution for exclusively public purposes, and
- charitable organizations that meet the purpose, organizational and operational tests for Section 501(c)(3) entities and are created or organized in the United States or a U.S. possession or under the law of the United States, a state, the District of Columbia or a U.S. possession.<sup>123</sup>

Contributions can come from individuals and corporations, as well as other charitable organizations.

When considering the effect these rules may have on the organization's fundraising strategy, it is important to remember that the universe of organizations that can receive tax-deductible charitable contributions is not limited to organizations that qualify as charitable organizations under Section 501(c)(3). It also includes tribal governments treated as states for purposes of the deductibility rules that govern charitable contributions.<sup>124</sup>



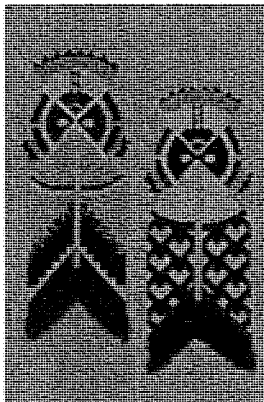
The Chickasaw Foundation was formed in 1971 to promote the general welfare and culture of the Chickasaw people by supporting educational, health, historical and community activities and programs. It derives its support from individuals, tribal vendors, other nonprofit organizations and foundations, federal government grants and tribal business enterprises. The foundation is based in Ada, Oklahoma, and received formal recognition of its tax-exempt status under IRC Section 501(c)(3) in 1980.<sup>125</sup>

<sup>122</sup> IRC § 7871(a)(1)(A) treats tribal governments as states for purposes of the charitable deduction rules under IRC § 170.

<sup>123</sup> IRC § 170(c)(2) limits the deductibility of donations to certain charitable organizations exempt under IRC § 501(c)(3) that are created in the United States or organized under the laws of the United States, a state, the District of Columbia or a U.S. possession. Notwithstanding this clearly alternative formulation, confidential correspondence received by the one of the authors indicates that some IRS district-level reviewers have questioned the ability of U.S.-based organizations formed under tribal law to obtain tax-exempt status or to receive tax-deductible contributions.

<sup>124</sup> IRC § 7871(a)(1)(A). In addition, veterans' organizations, domestic fraternal organizations and cemetery companies are also eligible to receive tax deductible donations if the donation is made for exclusively charitable purposes. IRC § 170(c)(3), (4) and (5). An extensive discussion of the limits on donors with respect to their ability to deduct charitable contributions made to private foundations and public charities can be found in Chapter 5.

<sup>125</sup> Source: NAP Survey, *supra* note 3 at 24; and material supplied by the Chickasaw Foundation.



**T**he Hopi Foundation was established in 1985 to provide educational, developmental and technical assistance to the Hopi population and other indigenous peoples. Based in Hotevilla, Arizona, it received public charity status from the IRS because of its broad base of financial support. The foundation is a medium-sized organization, with an annual income of approximately \$250,000. In 1994, its board established an endowment fund to provide long-term sustainable funding for the foundation.

Hopi Foundation accomplishments include establishment of NativeSUN, a solar electric enterprise; the Center for the Prevention and Resolution of Violence, a haven for Central American refugees in Tucson; a national public radio station; and an educational scholarship fund. The foundation has also published a book written by local children, distributed thousands of books to school students, returned sacred objects to their villages and restored ancient clan houses.<sup>126</sup>

### TRIBAL CHARITABLE FOUNDATIONS: PRIVATE FOUNDATIONS OR PUBLIC CHARITIES?

Because of inconsistencies in the IRC's treatment of Indian tribes as states, it is not entirely clear whether a charitable foundation controlled and funded exclusively by an Indian tribe will be classified as a private foundation or a public charity. Although the IRC treats tribal governments as states for purposes of the deductibility of contributions, it makes no specific provision for treating tribal governments as states for purposes of the public charity classification tests in Section 509(a). Thus, in contrast to the treatment of states and funding received by a 501(c)(3) entity from a state, current tax law does not specify:

- To what extent tribal funding can be counted as public support for purposes of the public support test under Section 509(a)(1) or the gross receipts test of Section 509(a)(2)—(the 2 percent question).<sup>127</sup>

- Whether an Indian tribe can be treated as a government or governmental unit for purposes of supporting organization test under Section 509(a)(3).<sup>128</sup>

Notwithstanding these uncertainties, the current position of the IRS, as articulated in its Internal Revenue Manual, is that Indian tribes are to be treated as states for purposes of public charity/private foundation classification under IRC 509(a)(1).<sup>129</sup> Moreover, other obvious routes exist to qualify for public charity status. For example, a tribal foundation that is formed as a supporting organization to a community foundation will qualify as a public charity. In addition, a tribal foundation can become a public charity by passing the "public support" or "gross receipts" tests described in IRC Sections 509(a)(1) and 509(a)(2). To ensure that such criteria are met, the tribal charity must be prepared to solicit financial support from a broad base of donors—individuals (including members of the Indian

<sup>126</sup> Source: NAP Survey, *supra* note 3 at 28; and materials supplied by the Hopi Foundation.

<sup>127</sup> See text accompanying notes 72-772.

<sup>128</sup> See text accompanying note 88. In the opinion of the authors, these are gray areas of the law that could be clarified by an IRS regulation or ruling.

<sup>129</sup> Internal Revenue Manual, *Private Foundation Handbook* (7752) § 260 states as follows: "Organizations excluded from private foundation classification pursuant to IRC § 170(b)(1)(A)(v) are governmental units referred to in IRC § 170(c)(1). These are states, possessions of the United States, or any political subdivision thereof, the United States, or the District of Columbia. Indian tribal governments are also excluded pursuant to IRC § 7871 (a)(7)(B)." The Internal Revenue Manual represents the position of the IRS, but is not legally binding precedent.

tribe), corporations, foundations and government sources.

Furthermore, establishing a board that is representative of the community may also be required. A representative board may diminish the control of the tribal government over the charity.

## **PUBLIC CHARITY STATUS AND ISSUES OF SOVEREIGNTY**

Generally, Indian tribes do not seek recognition of tax-exempt status as 501(c)(3) organizations because they are already immune from tax by virtue of their governmental status. As a government, an Indian tribe is neither a public charity nor a private foundation. The IRC classifies other governments, but not tribal governments, as public charities.<sup>130</sup>

If an Indian tribe establishes a separate charitable corporation for grantmaking and/or grantseeking purposes, it is usually desirable to maintain the status of that entity as a public charity. Unfortunately, the IRC does not provide tribal-controlled or tribal-funded entities with the benefit of the same clear, generally favorable rules afforded state-controlled or -funded entities. A charitable organization that is controlled by or operated for the benefit of a state or local government can easily obtain public charity status as a "supporting organization" under IRC Section 509(a)(3).<sup>131</sup> Indian tribes are not explicitly treated as states for this purpose.

A similar lack of parallel treatment affects the application of the public support test under Section 509(a)(1) and the gross receipts test under Section 509(a)(2). Although state governmental funding clearly constitutes governmental support without limitation for purposes of these tests, tribal governmental support may not (this is the 2 percent question).<sup>132</sup> Nevertheless, a

tribal organization that receives substantial funding from the tribal government may qualify for public charity status if it receives at least 10 percent of its support from members of the public and/or another governmental unit as described in Section 170(c).

## **Tribal Governments**

When the IRC lists governments that are treated as public charities, it includes states, possessions of the United States, political subdivisions of a state or possession, the United States and the District of Columbia. American Indian tribes and tribal governmental units are not included in the list, which makes their status as public charities unclear. The IRC's failure to specify the status of Indian tribes and tribal governments in this regard also creates uncertainty with regard to the status of Section 501(c)(3) organizations funded and controlled by tribal governments.

The Internal Revenue Manual—the IRS' internal procedures for implementing the IRC—sheds some light on the federal government's position regarding tribal governments as Section 501(c)(3) entities. In this manual, the IRS takes the position that a tribal government itself "will not qualify for exemption as described under IRC Section 501(c)(3), rather, it is simply not taxed."<sup>133</sup> Moreover, IRS employees are directed to reject applications for tax-exempt status under Section 501(c)(3) that are received from federally chartered tribal corporations organized under Section 17 of the Indian Reorganization Act. The manual does, however, say that if a tribal government "organizes a separate entity to conduct certain activities" and "incorporates it under state law," the organization may qualify for Section 501(c)(3) status if it otherwise meets the organizational and operational tests of Section 501(c)(3). This approach is consistent with the IRS' position that

<sup>130</sup> The Internal Revenue Manual, however, does treat Indian and tribal governments as public charities in the same way that states are treated as such. See *supra* notes 66–67.

<sup>131</sup> See *supra* notes 80–81 and accompanying text for a discussion of supporting organizations.

<sup>132</sup> Source: NAP Survey, *supra* note 3 at 28; and materials supplied by the Hopi Foundation.

<sup>133</sup> Internal Revenue Manual, *Exempt Organizations Handbook* (7751) § 34(12)7 (interpreting Rev. Rul. 67–284, which holds that tribal governments are not taxable entities).

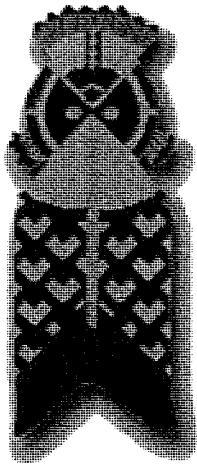
corporations organized by tribal governments under state law do not share the tax status of the tribal government.<sup>134</sup>

The IRS' preference for incorporation under state law is not, however, entirely consistent with the tax code. Rather, under Section 170(c)(2)(A), a charitable entity must be formed in the United States or under state law.

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<sup>134</sup> See Rev. Rul. 94-16, 1994-1 C.B. 19.

## CHAPTER THREE



# TRIBAL OPTIONS FOR GRANTMAKING

**D**ecisions to establish formalized giving programs are often based on traditions, the desire to create a lasting legacy, the need to address common problems on a local, regional, national or international level and, sometimes, the realization that a successful business enterprise has resulted in a surplus of funds that, if properly used, could improve the quality of life of others. Indian tribes, corporations and individuals all create formal giving programs for these reasons.

Creating a philanthropic entity that is legally distinct from an Indian tribe or tribal enterprise has certain benefits:

- a separate charitable entity provides a publicly identifiable mechanism for grantmaking apart from the tribal government or enterprise,
- it focuses the attention of grantseekers on the charitable organization itself, rather than the governmental or economic development activity of the Indian tribe,
- it fosters diversity in approaches to addressing social needs, and
- it provides a permanent structure with a greater potential for avoiding the complications that can arise with changes in elected leadership.

Indian tribes have a number of options in developing such a program. It is, therefore, important for tribal leaders to develop their vision of the tribal charity and the purposes it will serve before deciding on a specific philanthropic form. Questions that are likely to arise include the following:

- Does the Indian tribe want to address primarily the needs of its own community or to support causes outside of the Indian tribe's geographic boundaries or community?
- Does the Indian tribe envision providing direct assistance to individuals or making grants to other organizations that serve public purposes?
- Does the Indian tribe want to provide services itself or to fund other service providers?

Consideration of how the program will be funded is also important in early planning. Potential funding sources include investment proceeds, revenues from a tribal government or tribal enterprise and donations from individuals

and other organizations. If the purposes of the program include support for intertribal, regional, national or international causes, an Indian tribe might also want to consider forming a charitable corporation or an entity funded jointly with other Indian tribes.

A tribal philanthropic program will not face the same tax concerns as a program established by individual or corporate donors. For example, a tribal government—because it is already exempt from federal taxes on income, including any income derived from funds set aside for charitable giving—will not have to be concerned with structuring a program that generates tax deductions for the Indian tribe.

A tribal giving program will, however, be influenced by a variety of other legal and tax concerns, including tribal sovereignty issues and whether donors can obtain tax deductions for contributions to the giving program. For some Indian tribes, an additional consideration in constructing a giving program is the legal requirements of the provision of the Indian Gaming Regulatory Act (IGRA) that limits the use of net revenues from gaming to such purposes as providing for the general welfare of the Indian tribe and its members, promoting tribal economic development and donating to charitable organizations.<sup>135</sup>

This chapter provides an overview of philanthropic forms that Indian tribes are currently using.

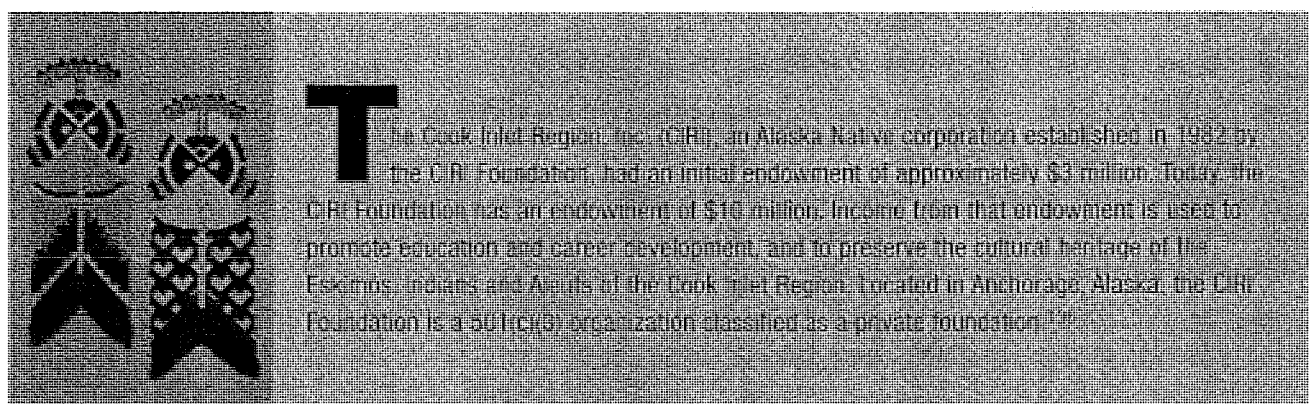
## OPTIONS FOR INDIAN TRIBAL GIVING

Over the years, Indian tribes have used four grantmaking forms to structure their philanthropic activities—a government charitable fund, an enterprise giving program or foundation, a tribal or intertribal public charity or a combination thereof. Generally, issues of tribal sovereignty, ease of administration and tax implications are the basis on which a particular structure is selected. Although Indian tribes often have similar needs and concerns, because each is unique, no single grantmaking vehicle will suit all tribal entities.

Regardless of the organizational form used, most grantmaking programs are the result of endowments. In general, endowments are permanent funds that use income generated from principal for charitable purposes. The chief feature of an endowment is that, by preserving the principal, it can provide a permanent source of funding for such things as a hospital or a school, individual scholarships and the provision of essential social services. An endowment may be maintained within the existing tribal structure, or it may be separately incorporated.

### Indian Tribal Government Charitable Fund

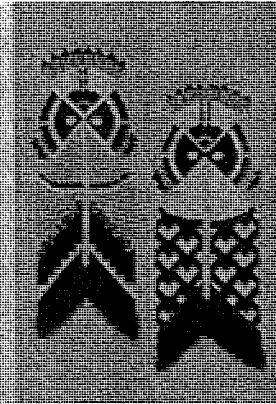
An Indian tribal government charitable fund is a giving program funded by the Indian tribe, but not incorporated as a separate entity. It may be operated by a particu-



<sup>135</sup> See 25 U.S.C. § 2710(b)(2)(B) (regulating the use of proceeds derived from Class II and Class III gaming). In 1988, Congress passed IGRA to “provide a statutory basis for operating gaming to promote economic development, to shield Tribes from organized crime, to ensure fairness to operators and players, and to establish a federal regulatory authority for Indian gaming to meet Congressional concerns.” S. Rep. No. 100-446, 2 (1988).

<sup>136</sup> Source: NAP Survey, *supra* note 3 at 25; and materials supplied by the CIRI Foundation.

**T**he Mashantucket Pequot Tribal Nation has established an unincorporated tribal giving program as a program of the tribal government. Through the program, it has made significant donations to a wide variety of worthy causes, including a \$10 million grant to the Smithsonian Institution's National Museum of the American Indian, a \$5 million grant to the Mystic Aquarium, several gifts to the Special Olympics and substantial contributions to the Native American Rights Fund. The Mashantucket Pequot Tribal Nation operates Foxwoods Resort and Casino, which is located on the Mashantucket Pequot Reservation in Mashantucket, Connecticut, and employs approximately 13,000 people.<sup>137</sup>



lar department or division of the Indian tribe or administered directly by the tribal council. The fund can be structured in these ways:

- an endowment can be created by setting aside a lump sum of money and using the investment income to fund charitable programs, if tribal funds are to be used, or
- a specific percentage of the Indian tribe's annual net operating revenue can be budgeted to fund charitable projects or grants.

### Indian Tribal Sovereignty

Establishing an Indian tribal fund does not subject the Indian tribe to any limitations on its sovereignty. An unincorporated fund of the tribal government is not usually subject to the state laws that govern trusts or nonprofit corporations, and the tribal council may retain complete control over the fund without ceding any authority to an independent board of directors. Similarly, because the fund operates as a part of the Indian tribe, there is no risk of subjecting tribal assets to state regulation.

### Administrative Issues

A tribal government charitable fund is the easiest and simplest philanthropic program to administer. The

main requirements for managing such a fund are creating general rules for its operation, selecting a professional investment manager, drafting and implementing written guidelines for grantmaking procedures and recruiting and training a staff to implement the fund.

There are, however, disadvantages to having a fund administered directly by the tribal government. In contrast to an entity such as a trust or a corporation, the governing body of a tribal fund is not legally distinct from the Indian tribe's own governing body. As a result, tribal officials may find themselves on the receiving end of direct requests for money. Moreover, because the fund may be administered by elected representatives of the Indian tribe, politics—including the perception of their presence—are more likely to enter the grantmaking process. Even when administered by staff or a special committee, a charitable program set in place by tribal representatives in one year may be changed or abandoned when new leaders take office.

### Accountability

Although a tribal fund is not subject to Section 501(c)(3) reporting requirements,<sup>138</sup> the Indian tribe will likely want to establish mechanisms to ensure that the program is administered properly. This is particularly important if the Indian tribe intends to attract donors or to affiliate with other grantmaking organizations,

<sup>137</sup> Source: Joseph, *Options*, *supra* note 3 at 16–17; and material supplied by the Mashantucket Pequot Tribal Nation.

<sup>138</sup> See Chapter 5 for further information.



who typically want assurance that their funds are being used for charitable or exclusively public purposes.

Grantmakers look more favorably on organizations that have accountability mechanisms in place; thus, formalized accountability practices improve chances of obtaining grants from other organizations. Without accountability mechanisms, attracting outside sources of support—particularly corporations and foundations—will be difficult, in part, because the IRS may question the deductibility of contributions made to a nonaccountable fund.

Accountability mechanisms—monitoring procedures, reporting requirements and other measures designed to protect and promote a fund's integrity—can be self-imposed by the Indian tribe. In addition, an Indian tribe might consider adopting language in the fund's governing instrument, a tribal ordinance or even the tribal constitution to the effect that the Indian tribe will use all grants and contributions for exclusively public purposes and only in accordance with the purposes for which they were given.<sup>139</sup>

### Tax Implications

A tribal government charitable fund that has not been organized as a separate corporate entity shares the same tax immunity as the Indian tribe and is usually eligible for donor-related tax benefits. Corporate and individual donors can deduct their contributions to a recognized tribal government fund if the contributions are made for exclusively public purposes.<sup>140</sup> Similar deductions may be taken for federal gift and estate tax purposes.<sup>141</sup>

The same donor tax benefits apply to qualified "political subdivisions" or "integral parts" of a tribal gov-

ernment. In reference to this issue, Section 7871 provides that:

- A political subdivision may receive tax-deductible contributions if it has been delegated the right to exercise one or more of the substantial governmental functions of the tribal government (the power to tax, the power of eminent domain and the police power).<sup>142</sup>

In addition, IRS rulings issued to tribal governments under Section 7871 have provided similar treatment to tribal entities that:

- perform essential governmental functions on behalf of the Indian tribe, and
- are sufficiently controlled by the tribal government.

Such entities qualify for tax deductible contributions on the ground that they constitute an "integral part of the Tribe."<sup>143</sup>

Before a charitable fund administered by an Indian tribe is eligible for tax benefits under Section 7871, however, the Indian tribe (or tribal subdivision) must be recognized by the Department of the Interior and the Secretary of the Treasury. If such status is recognized, the Indian tribe need not obtain charitable status under IRC Section 501(c)(3).

A tribal fund is not usually subject to the federal and state requirements imposed on separately organized tribal charitable organizations. State laws that govern charitable trusts and nonprofit corporations do not apply to Indian tribes. Moreover, because a tribal government charitable fund does not derive its tax status from IRC Section 501(c)(3), the fund is not subject to the tax restrictions that apply to 501(c)(3) charitable

<sup>139</sup> For example, during a tax audit of one donor's estate, the IRS questioned the deductibility of a bequest to an Indian tribe. The issue was resolved favorably because the IRS found language in the tribal constitution that required the tribe's secretary-treasurer to use the bequest for "exclusively public purposes." Without such language, the IRS might have ruled otherwise because the tribe could have used the gift for "any personal interest or private persons." Tech. Adv. Mem. 8751002 (Dec. 17, 1986). See Appendix D for sample language.

<sup>140</sup> IRC §§ 170(c)(1), 7871(a)(1)(A).

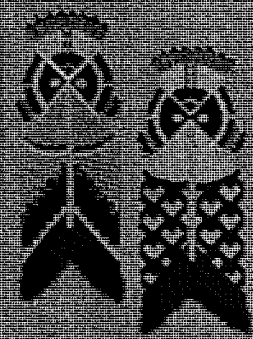
<sup>141</sup> IRC §§ 7871(a)(1)(B)-(C).

<sup>142</sup> IRC §§ 7871(a) and (d). See Rev. Rul. 77-165, 1977-1 C.B. 21.

<sup>143</sup> See Priv. Ltr. Rul. 8950017 (Sept. 15, 1989) (tribal community organization that lacks sovereign powers does not qualify as a political subdivision, but nonetheless shares the Indian tribe's tax status under § 7871 because it is an "integral part" of the tribal government); see also Priv. Ltr. Rul. 8543016 (July 12, 1985) (tribal court is not a political subdivision, but qualifies as instrumentality or integral part of the Indian tribe).



In 1990, the Menominee Tribe of Wisconsin began using its gaming proceeds to provide operating funds for special programs of the Menominee College, their tribal college, as well as support for a score of local activities, events and tribal infrastructure projects. These charitable allocations are generally approved by the Menominee Tribal Legislature.<sup>144</sup>



organizations. In addition, a tribal fund will not have to comply with the complex rules that govern private foundations.

### Tribal Enterprise Giving Program

A tribal enterprise giving program is a charitable program funded by and established as a department or division of a tribal enterprise, such as a tribal casino. Like a tribal charitable fund, it is not a separately incorporated organization.

Typically, this type of grantmaking vehicle funds programs through a dedicated portion of the net operating revenue of the tribal enterprise, rather than through an endowment. Using this form for giving helps an Indian tribe to:

- align its philanthropy with tribal economic objectives,
- involve employees directly in the Indian tribe's charitable giving program, and
- have a program that can serve as part of a "revenue allocation" plan—a plan that allocates gaming revenue to a range of public purposes,

including tribal government projects, social welfare programs, scholarships and charitable contributions and grants.<sup>145</sup>

In most instances, a tribal enterprise giving program shares many of the advantages of a charitable fund. If the tribal enterprise is a taxable entity, however, the tax benefits associated with the giving program are somewhat more restricted.

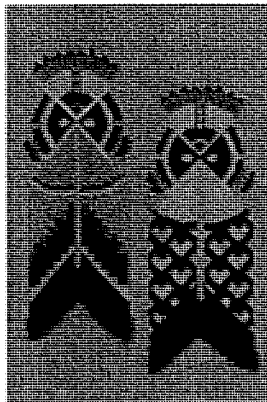
If a tribal enterprise shares the Indian tribe's federal tax exemption, an unincorporated giving program that operates as a division of that enterprise will also be exempt from federal income taxes. Because a federally chartered tribal corporation is not considered a separate entity for federal tax purposes,<sup>146</sup> individual employees' contributions to such a corporation's giving program should also be deductible under IRC Sections 7871(a)(1)(A) and 170, just as donations to the Indian tribe itself are deductible. An unincorporated giving program operated as a division of a tax-exempt tribal enterprise is not required to file a tax return. Note, however, that, although federally chartered corporations share the Indian tribe's tax-exempt status, state-chartered corporations do not.<sup>147</sup>

<sup>144</sup> Source: Material supplied by the Menominee Indian Tribe of Wisconsin.

<sup>145</sup> Pursuant to a provision of the Indian Gaming Regulatory Act, an Indian tribe may use net gaming revenues to make *per capita* payments to tribal members only if, *inter alia*, the tribe has prepared a plan to allocate revenues to authorized governmental or charitable uses. 25 U.S.C. § 2710(b)(3). See Tribal Revenue Allocation Plans, 61 *Fed. Reg.* 29044 (June 7, 1996).

<sup>146</sup> See Treas. Reg. § 301.7701-1(a)(3).

<sup>147</sup> Rev. Rul. 94-16, 1994-1 C.B. 46. As noted in the Introduction, the tax status of tribal-chartered corporations formed and controlled by an Indian tribe remains unclear. Informally, the IRS has indicated that it will consider the tax status of tribally chartered corporations on a case-by-case basis. Under existing tax law precedents, a tribally chartered corporation arguably should be treated as tax-exempt if it operates as an "integral part" of the tribal government. See Treasury Dec. 8697 (Dec. 17, 1996), 61 *Fed. Reg.* 66585 (Treasury and the IRS are studying the issue of the tax treatment of entities wholly owned by an Indian tribe and incorporated under tribal law). The tax immune status of tribally chartered corporations is also supported by the Supreme Court's decision in *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 157 n. 13 (1973) stating that, "the question of tax immunity [for a § 17 Indian Reorganization Act corporation] cannot be made to turn on the particular form in which the Tribe chooses to conduct its business." An Indian tribe's decision to operate an enterprise through a corporation wholly owned by the tribe and incorporated in the exercise of the tribe's sovereign authority should have the same tax status as the tribe. See also discussion in Chapter 5, Governing the Organization, State of Tribal Law.



**T**he Shakopee Mdewakanton Dakota Community has donated substantial sums to charitable causes both directly from the tribal government and through its corporate arm, Little Six, Inc. In 1993, it contributed approximately \$1.3 million to various causes, including \$44,000 (the largest corporate gift in the State of Minnesota) to the Jerry Lewis Telethon for Muscular Dystrophy. Little Six, Inc., operates the Mystic Lake Casino near Minneapolis, Minnesota.

In a few instances, tribal business enterprises are operated as taxable corporations, such as Alaska Native corporations, tribal corporations that are not wholly owned by the Indian tribe and state-law corporations are examples of such entities. Although it does not enjoy the privileges of a tax-exempt entity, a taxable tribal enterprise can reduce its taxable income by making deductible grants and other charitable contributions to Section 501(c)(3) organizations through a charitable giving program. Under IRC Section 170(b)(2), a corporation can deduct contributions of up to 10 percent of the corporation's taxable income for the year. Individual contributions to a taxable enterprise's giving program would not, however, be deductible to the donor. As a result, a tribal enterprise chartered under state or tribal law may have to form a separate 501(c)(3) organization if it intends to solicit individual or outside contributions to further its charitable giving program.

The advantages and disadvantages of a tribal enterprise giving program are similar to those of a tribal government charitable fund. The Indian tribe preserves its sovereignty by operating the fund as part of the Indian tribe or tribal enterprise. This opens tribal officials or tribal enterprise senior management to direct solicitation by grantseekers, and the giving program is more vulnerable to political pressure, including changes in tribal policy or in the Indian tribe's elected leadership.

Because all of the funds that support this form of grantmaking entity come directly from tribal enterpris-

es, the enterprise will be accountable to the tribal government, rather than to individual donors or to the general public. This can be a benefit because it may reduce the workload of those who must prepare associated paperwork, but it can also serve to lessen public awareness and appreciation of activities supported by the Indian tribe. Consequently, the tribal enterprise may wish to engage in public relations activities in conjunction with its grantmaking.

#### **Tribal Foundation or Tribal Enterprise Foundation**

A tribal foundation is a charitable giving vehicle established and funded by an Indian tribe or tribal enterprise as a separate trust or nonprofit corporation. In general, to gain tax-exempt status, a tribal foundation must obtain IRS recognition as a Section 501(c)(3) organization. When so recognized, a tribal foundation is subject to federal tax law to the same degree as any other Section 501(c)(3) organization. In addition, if the corporation is organized under state law (rather than tribal law), it is also subject to state corporate and charitable giving law. This treatment contrasts with that of a tribal government charitable fund or a tribal enterprise giving program, which generally are not subject to such laws.

A potential problem in securing public charity status for a tribal foundation arises from a gap in IRC Section 7871. As discussed in Chapter 2,<sup>149</sup> Section 7871 treats tribal governments as governmental entities

<sup>148</sup> Source: NAP Survey, *supra* note 3 at 25 (citing comments by former Little Six, Inc., official Sean Patrick Murphy).

<sup>149</sup> See text accompanying notes 74-77.

for purposes of deducting charitable contributions and application of private foundation excise taxes, but not for purposes of determining public charity status. As a result, support from a tribal government may be subject to the 2 percent cap in public support calculations, and the tribal foundation may be classified as a private foundation rather than a public charity.<sup>150</sup> If this occurs, the organization would become subject to all the private foundation restrictions. A donor to a private foundation is also subject to more restrictive rules on deductibility than is a donor to a public charity. This problem can be avoided by combining tribal support with grants and gifts from other sources to ensure that it passes the public support test.

Separately organized tribal foundations must determine at the outset whether they wish to be recognized as a charitable organization under IRC Section 501(c)(3) or as an "integral part" of the tribal government under Section 7871. Under current tax law, this is a difficult choice. Because of inconsistencies in the IRC, tribal foundations that select the 501(c)(3) option risk being classified as private foundations rather than public charities, and restrictions under private foundation rules can be burdensome.

### **Tribal or Intertribal Public Charity**

A tribal or intertribal public charity is established and funded by one or more Indian tribes or tribal organiza-

tions as a separate nonprofit corporation. The organization may obtain and maintain public charity status if it is funded on an ongoing basis by individual and governmental contributions or grants in proportions sufficient to meet the public support tests of IRC Sections 509(a)(1) or 509(a)(2). A tribal or intertribal charity, including a tribal foundation, may also achieve public charity status by operating as a Section 509(a)(3) supporting organization to another tax-exempt organization.

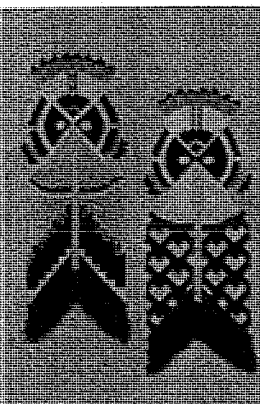
When compared with a private foundation, a tribal or intertribal public charity offers higher charitable deduction limitations and less regulation. But operating these requires an ongoing fundraising program. In addition, Indian tribes may have to sacrifice tribal government control to retain public charity status.

### **Supporting Organization**

A tribal or intertribal public charity can avoid the need for meeting a public support test by qualifying as a public charity on the grounds that it is a Section 509(a)(3) supporting organization. A tribal or intertribal charity may be formed as a supporting organization to a community foundation or any other public charity. Whether this is desirable depends, of course, on the purposes and objectives of the entity.

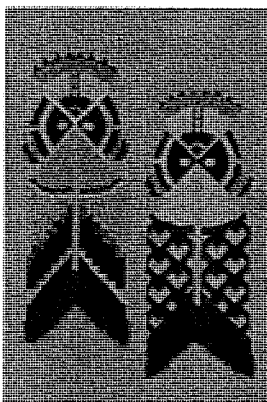
Under certain circumstances, supporting organization status has its own drawbacks. For instance, if the

**F**ounded in 1981 by Sealaska Corporation, the Sealaska Heritage Foundation is a Section 501(c)(3) organization and public charity whose mission is to preserve and enhance the Tlingit, Haida and Tsimshian cultures. To support this mission, the foundation raises funds from the public and private sectors. Funds are used to design and operate Native language immersion classes, language teacher certification and curriculum development programs, a scholarship program, youth and summer camps and clan history workshops. The foundation's principal office is located in Juneau, Alaska.



<sup>150</sup> The Internal Revenue Manual, however, takes the position that an Indian tribe itself is excluded from private foundation classification. Internal Revenue Manual, *Private Foundation Handbook* (7752) § 260. See *supra* note 67.

<sup>151</sup> Source: NAP Survey, *supra* note 4 at 32; and materials supplied by the Sealaska Heritage Foundation.



**F**ounded in 1987, CERT Education Fund, Inc. (CEFI) is a charitable affiliate of the Council of Energy Resource Tribes (CERT), a multitribal organization composed of 48 American Indian tribes and four Canadian Indian Nations. Based in Denver, Colorado, both CERT and CEFI are recognized as tax exempt under Section 501(c)(3).

CEFI provides programs and services that complement CERT technical services, strengthen existing tribal expertise and support the sustained development of tribal human resource potential. For example, CEFI works to foster positive and supportive relationships with tribal community colleges and education officers to advance educational and professional options for tribal members. CEFI also provides an internship program for American Indian col-

lege and graduate students, as well as a precollege bridge program, the Tribal Resource Institute in Business, Engineering and Science (TRIBES). CEFI's 1996 income of more than \$745,000 was dedicated wholly to providing educational and professional development projects, training and curriculum development, including approximately \$75,000 in scholarship aid to eligible American Indian students.<sup>152</sup>

public charity that the tribal or intertribal charity supports has the authority to appoint a majority of the tribal or intertribal charity's board, individual tribal control may be significantly diminished. In addition, conflicting program agendas may develop. For this reason—specifically, to reduce the possibility of later conflict—the expectations of all parties are best fully articulated in writing from the outset if this option is to be used.

### Intertribal Consortia

Some Indian tribes have organized intertribal consortia as Section 501(c)(3) corporations, and in at least two rulings—one by the 10th Circuit Court of Appeals and the other by the National Labor Relations Board—those consortiums have been given quasigovernmental status for purposes of the federal laws at issue.<sup>153</sup> Although no general statement of law can be drawn

from these two cases, they suggest that the formation of intertribal consortiums for governmental purposes is an option that Indian tribes may want to consider. Obtaining legal advice before organizing such a consortium is essential because the law has just begun to develop in this area.

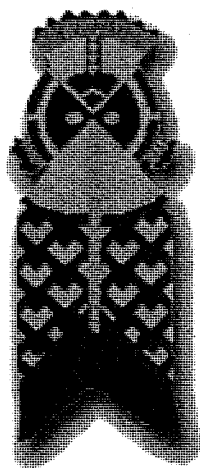
### Intertribal Political Subdivisions

The IRS has recognized an intertribal governmental agency as a political subdivision under Section 7871.<sup>154</sup> It is not clear, however, under what circumstances an intertribal consortium or charity could obtain similar tax treatment.

<sup>152</sup> Source: NAP Survey, *supra* note 3 at 25; and materials supplied by CERT.

<sup>153</sup> See *Dille v. Council on Energy Resource Tribes*, 610 F. Supp. 157 (D.C. Colo. 1985), *affirmed*, 801 F.2d 373 (10th Cir. 1986) (intertribal consortiums should be treated in a manner similar to multistate agencies; although CERT obtained recognition from the IRS as a § 501(c)(3) organization, it fell within the "tribal government" exclusion from Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e et seq.)); see also *Toiyabe Indian Health Project, Inc.*, NLRB GCM, Case No. 31-CA-19604 (May 28, 1993) (although Toiyabe was a nonprofit corporation, the National Labor Relations Board had no jurisdiction over a dispute involving the corporation because it fell within the "governmental entity" exclusion under the National Labor Relations Act). See also *Ft. Apache Timber Co.*, 226 NLRB 503 (1976) (holding tribal enterprise was not an employer under National Labor Relations Act); *Southern Indian Health Council, Inc.*, 290 NLRB 436 (1988) (holding intertribal consortium was not an employer under National Labor Relations Act).

<sup>154</sup> Priv. Ltr. Rul. 9409031 (Dec. 7, 1993) (an intertribal housing authority formed by 12 tribes qualified as a political subdivision for § 7871 purposes).



## TRIBAL OPTIONS FOR GRANTSEEKING

**A**lthough grantmaking organizations provide support for charitable programs, individuals or other organizations, grantseeking entities look for funds to carry out their programs. Grantseeking organizations are the tribal museums or libraries that must solicit gifts to operate. They are the economic development corporations that provide grants or other services to businesses in economically depressed communities. They are the clinics that bring medical services to communities lacking adequate numbers of physicians.

Like some grantmakers, grantseeking organizations are public charities and qualify for tax-exempt status. The two entities sometimes take identical organizational form and sometimes serve the same needs. Moreover, they operate under the same statutes. Where these two types of organizations diverge is in funding. Grantmakers are formed because a funding source that wishes to be involved in philanthropic endeavors exists. Grantseeking organizations are founded to fill a need and must solicit funds to meet that need. Having an existing source of funds is a prerequisite to becoming a grantmaker; searching for the funds needed just to keep the doors open is commonplace for many grantseekers.

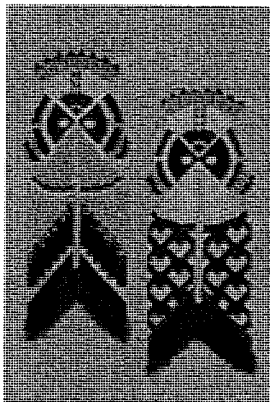
Two issues are critical to beginning and operating a successful grantseeking operation. First, what philanthropic form should it take? Second, what funding issues must be addressed? This chapter reviews deductibility and tax-exemption issues as they relate to grantseeking organizations, comparing the benefits and drawbacks of obtaining Section 7871 or Section 501(c)(3) status.

### PRELIMINARY CONSIDERATIONS

An early decision in establishing a grantseeking organization is whether to form under the auspices of Section 7871 or Section 501(c)(3).<sup>155</sup> That choice will affect on the ultimate organizational form the grantseeking entity takes.

<sup>155</sup> See Chapter 1 for a review of § 7871 status and Chapter 2 for a review of § 501(c)(3) status.





**T**he Laguna Educational Foundation was established exclusively for educational purposes—such as providing scholarships, enhancing existing educational services and providing support to innovative educational programs—in 1996. Administered by the Pueblo of Laguna Department of Education and located in Laguna, New Mexico, the foundation derives its funding from public and private sources. The Pueblo of Laguna qualifies as an Indian tribal government under IRC Section 7871 and is eligible to receive tax deductible contributions. The foundation is governed by a nine-member board appointed by the Pueblo's Board of Education.<sup>156</sup>

## TAKING ADVANTAGE OF SECTION 7871 STATUS

A tribal government, a subdivision of a tribal government that exercises sovereign powers or a department or division that is an integral part of a tribal government may qualify for treatment as a state under Section 7871.<sup>157</sup> Such status has been sought and obtained by tribal community organizations, health and housing authorities and tribal educational foundations. Any donation received by a Section 7871 entity qualifies for a tax deduction for the donor, provided that the donation is made for an exclusively public purpose.<sup>158</sup> Section 7871 entities are not subject to annual reporting requirements, charitable substantiation and disclosure rules or the UBIT rules that apply to Section 501(c)(3) organizations.

### Seeking IRS Recognition

Before a tribal entity seeks tax deductible donations, it should first determine whether it is included in either the 1983 or 1984 IRS Revenue Procedure—a relatively

comprehensive, albeit dated, list of Section 7871 qualified Indian tribal government and tribal political subdivisions.<sup>159</sup> If it is not, a request for a private letter ruling must be submitted to the IRS to confirm the Indian tribe's status under Section 7871.<sup>160</sup> Although professional legal assistance is required to prepare and submit such a request, the process is often less time consuming than completing the application for recognition of tax-exempt status under Section 501(c)(3). As a general rule, submission of a request for a private letter ruling should be handled by an experienced tax counsel working closely with the Indian tribe's general counsel.<sup>161</sup>

### Section 7871 Limitations

Section 7871 also has important limitations. First, contributions to a Section 7871 tribal entity must be used for *public purposes*—a term that is not clearly defined under existing tax cases and rulings.<sup>162</sup> Second, some private foundations are still hesitant to make donations to entities whose public charity status is unclear.

<sup>156</sup> Source: Material supplied by the Laguna Educational Foundation.

<sup>157</sup> Under the IRC, an Indian tribal government is defined as "the governing body of any Tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary, after consultation with the Secretary of the Interior, to exercise governmental functions." § 7701(a)(40).

<sup>158</sup> IRC § 7871(a)(1)(A) treats qualifying tribal governments and associated entities as states for purposes of the income tax deduction for charitable contributions.

<sup>159</sup> See Rev. Proc. 83-87, 1983-2 C.B. 606 (Indian tribal governments); and Rev. Proc. 84-36, 1984-1 C.B. 510 (tribal subdivisions).

<sup>160</sup> Rev. Proc. 84-37, 1984-1 C.B. 513 explains the procedure for requesting treatment as a state under 26 U.S.C. § 7871. See Chapter 5 for a detailed discussion of applying for a private letter ruling under § 7871.

<sup>161</sup> See Chapter 5 for a more complete description of this process.

<sup>162</sup> For example, the IRS has held that a contribution to a state bar association was not deductible for income, estate or gift tax purposes because the organization had both private and public objectives. See Rev. Rul. 77-232, 1977-2 C.B. 71. It has also ruled, however, that contributions to volunteer fire departments are deductible because they are used for exclusively public purposes. Rev. Rul. 71-47, 1971 C.B. 92, as clarified by Rev. Rul. 74-361, 1974-2 C.B. 159. The Tax Court has held that a donation of an interest in a sewer system was deductible because the sewer line served a public purpose in facilitating the development of the city's industrial park and that contributions to a state department of highway safety were deductible when used by the department for developing a highway safety program. See *C.W. Myers*, 81-1 U.S.T.C. 179 (1981); *H.M. Matheson*, 18 B.T.A. 674 (1930) *affirmed*, 54 F.2d 537 (2d Cir. 1931).

Still, Section 7871 has clear advantages, particularly for a tribal organization that is in the initial planning stages and has yet to determine whether Section 501(c)(3) status is feasible or desirable. In such cases, Section 7871 status provides an excellent interim vehicle for conducting charitable activities. If the tribal government decides subsequently to form a separate legal entity, Section 501(c)(3) status can be sought at a later date.

### USING SECTION 501(C)(3) STATUS

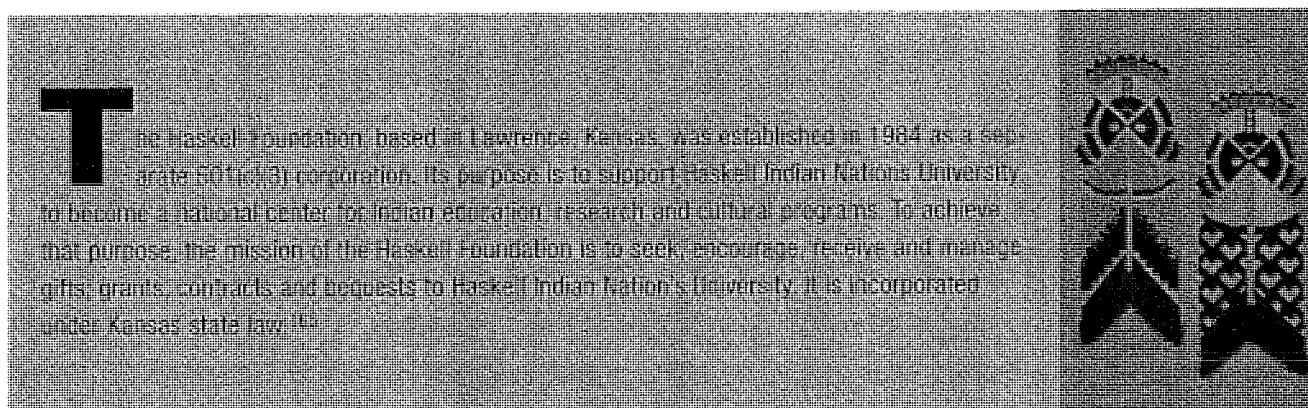
Section 501(c)(3) status can be a significant advantage to a tribal organization that plans to solicit funding, whether from individuals, corporations, other public charities or private foundations. With 501(c)(3) status, donations to the entity are tax deductible to the extent, and on the terms defined by, the IRC.

Most nonprofit entities with which a tribal grantseeking organization competes for donations are likely to have 501(c)(3) status, and thus can ensure tax deductions for donors. In addition, 501(c)(3) status, especially public charity status under Section 509(a), makes the entity a more attractive donee to private

foundations, some of which prefer to make grants to public charities because such donations clearly comply with IRC minimum distribution rules and do not trigger the taxable expenditure rules.<sup>163</sup>

Obtaining Section 501(c)(3) status may be particularly advantageous for separately organized tribal government entities that would not otherwise qualify under Section 7871 because they lack significant sovereign powers. Such entities need Section 501(c)(3) status to attract substantial funding from individual, corporate and foundation donors. Section 501(c)(3) status can make it easier for a tribal entity to participate in United Way and other charitable campaigns, and can facilitate membership in associations of charitable organizations. Section 501(c)(3) status also qualifies an organization for preferential postage rates.<sup>164</sup> All of these activities can, of course, be used to increase donations.

Like a tribal organization that seeks 501(c)(3) status for grantmaking purposes, a tribal governmental entity looking for 501(c)(3) recognition as a grantseeker must pass the IRC's operational, organizational tests and charitable purpose tests. As noted in Chapter 1, however, the IRS will grant Section 501(c)(3) status only to entities that do not have substantial sovereign



<sup>163</sup> See pp. 26–28 [at notes 109–112 and 114–116] for further information. Because § 7871 treats tribal governments as states for purposes of the private foundation rules, the minimum distribution and taxable expenditure rules should pose no barrier to private foundations making donations to tribal governments with status under that section.

<sup>164</sup> 39 U.S.C. §§ 4355(a), 4452(d).

<sup>165</sup> Source: Material supplied by the Haskell Foundation.

powers. Accordingly, the organization's charitable and educational activities must be conducted by a corporation or other entity that is separate from the tribal government itself and that lacks sovereign powers.<sup>166</sup>

## TAX STATUS UNDER SECTION 7871 VERSUS SECTION 501(C)(3)

Tax deductibility of donations is a primary tax benefit afforded to both Section 501(c)(3) organizations and Section 7871 Indian tribal governments and their subdivisions.<sup>167</sup> In addition to deductibility of donations, Section 7871 provides additional tax benefits, some of which are more generous than those afforded to Section 501(c)(3) organizations. Section 501(c)(3) offers certain federal tax benefits that are not afforded to Indian tribal governments under Section 7871.

Which form is best suited to an American Indian tribe's grantseeking and grantmaking objectives depends primarily not on tax benefits, but on structural decisions. If the charitable vehicle is an integral part of the tribal government (with inherent or delegated sovereign powers), Section 7871 status is most appropriate. But if the Indian tribe and its leaders wish to set up an entity that is separate from the tribal government, Section 501(c)(3) status may be the best route to both tax

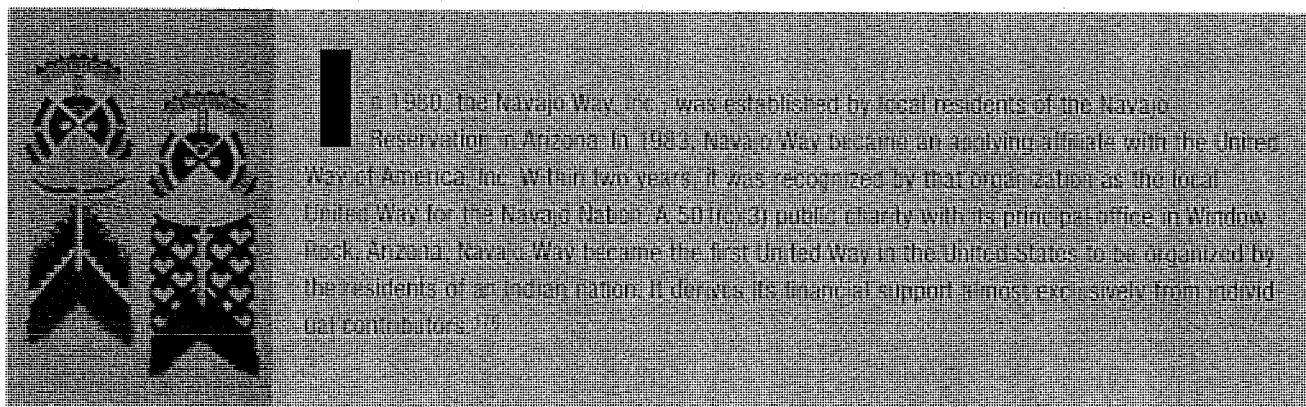
deductibility and other important benefits, such as tax exemption.

## Tax-Exempt Financing

Section 7871 provides American Indian tribes with tax-exempt bonding authority. Indian tribes may issue tax-exempt governmental bonds only for facilities used in the exercise of essential governmental functions—roads, sewers and schools. Indian tribes may also issue tax-exempt private activity bonds, but only for manufacturing facilities that meet certain specific requirements.<sup>168</sup> These requirements generally stipulate that:<sup>169</sup>

- 95 percent or more of the bond proceeds be used to finance manufacturing facilities located on qualified Indian land,
- such facilities must be owned and operated by the bond-issuing Indian tribe, and
- the face amount of the outstanding bonds issued to finance such facilities not be 20 times greater than the wages paid to employees in such facilities during the preceding year.

Section 501(c)(3) organizations do not themselves issue bonds, but can use the proceeds of bonds issued by state and local governments, subject to certain limitations. These limitations generally require that all the



<sup>166</sup> Internal Revenue Manual, *Exempt Organizations Handbook* (7751) § 34(12)7.

<sup>167</sup> IRC §§ 170(a)(1), (c)(1) and 7871(a)(1)(A).

<sup>168</sup> IRC § 7871(c)(3)(B).

<sup>169</sup> See id.

<sup>170</sup> Source: Materials supplied by the Navajo Way, Inc.



property provided by the bond proceeds be owned by the 501(c)(3) organization,<sup>171</sup> and that 95 percent or more of the proceeds be used for an activity that is *related* to the 501(c)(3) organization's exempt purpose.<sup>172</sup>

### Excise Taxes

Section 7871 provides Indian tribal governments with relatively broad excise tax exemptions. Such entities are afforded the same exemption as states from the special fuels excise taxes, manufacturers excise taxes, communications excise taxes and highway vehicle excise taxes.<sup>173</sup> Activities that give rise to any one of these potential excise taxes must, however, be performed by an Indian tribe as an essential governmental function. (An essential governmental function is an activity traditionally performed by a state or local government with general taxing powers.<sup>174</sup>)

Section 501(c)(3) organizations, by contrast, have limited exemptions from excise taxes. For example, IRC Section 4253(c), (h) & (j) exempts the American National Red Cross and some Section 501(c)(3) hospitals and educational organizations from the excise tax on communication services. Under IRC Section 4221(a)(5), only certain Section 501(c)(3) educational organizations are exempt from certain manufacturer's and retail excise taxes, from the special fuels tax under Section 4041(g)(4), and from the occupational tax imposed on persons or entities dealing in distilled spirits.<sup>175</sup>

### FUTA Taxes

With regard to the tax imposed by the Federal Unemployment Tax Act (FUTA), Section 501(c)(3) organizations and State and local governments are exempt from the tax.<sup>176</sup> Currently, the IRS takes the position that Indian tribal governments are subject to the full FUTA tax. Although the lack of precedential guidance, the inconsistency between state and federal agencies, as well as selective IRS enforcement, led many Indian tribes to question their FUTA obligations;<sup>177</sup> the IRS has taken the position that Indian tribal governments are to be treated as private employers under FUTA.<sup>178</sup>

### Nontax Considerations

Finally, certain provisions of federal laws that are unrelated to taxes afford Section 501(c)(3) organizations special exemptions or give such organizations special treatment.<sup>179</sup> For example, a Section 501(c)(3) grantseeking or fundraising organization may be eligible for preferred postage rates.

<sup>171</sup> IRC § 145(a)(1).

<sup>172</sup> IRC § 145(a)(2)(B).

<sup>173</sup> IRC § 7871(a)(2)(A)-(D).

<sup>174</sup> IRC § 7871(e).

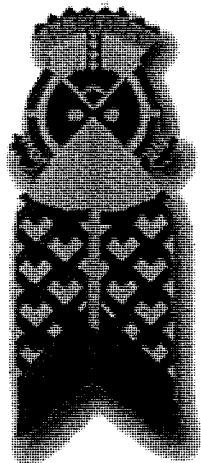
<sup>175</sup> In addition, the harbor maintenance tax under IRC § 4462 does not apply to IRC § 501(c)(3) organizations transporting cargo for humanitarian or development assistance overseas. For purposes of the excise tax on wagering, IRC § 4421(2)(B) excludes from the definition of lottery, all lotteries conducted by IRC § 501 and IRC § 521 organizations.

<sup>176</sup> See IRC §§ 3306(c)(7) and (c)(8).

<sup>177</sup> State governments, IRS and U.S. Department of Labor interpretations have varied from state to state and from region to region, resulting in differential treatment of Indian tribal governments. See Congressional Research Service, "Indian Tribal Government Treatment by State Unemployment Insurance Programs" (Feb. 16, 1989 memorandum by Roger Walke) and Congressional Research Service, "Indian Tribal Government Treatment by State Unemployment Insurance Programs: A Re-survey of State Practices" (Oct. 1, 1993).

<sup>178</sup> See, for example, Priv. Ltr. Rul. 8748004 (Aug. 27, 1987).

<sup>179</sup> For example, federal laws dealing with antitrust, securities regulation, involuntary bankruptcy, labor, copyright and certain crimes all provide limited exceptions for § 501(c)(3) organizations.



## STARTUP CONSIDERATIONS

**H**ow an Indian tribe structures its program will depend on its vision for the program and available resources. If, for instance, the Indian tribe decides to create a tribal fund or tribal enterprise giving program, a grantmaking mechanism that provides the ability to disburse funds for the Indian tribe's designated charitable purposes is needed. Alternatively, if the Indian tribe chooses to form a separately organized charitable entity, other structural issues must be considered.

This chapter details startup issues for grantmaking and grantseeking organizations, including the decisions and actions that the Indian tribe will likely want to consider concerning the legal form of the organization and its governance, management, staffing and fundraising.

### SEPARATELY ORGANIZED FOUNDATIONS AND CHARITABLE ORGANIZATION

Indian tribes that choose to form a separately organized foundation or other type of charitable organization must first decide which kind of organization is most appropriate—a trust, a corporation or an unincorporated association.

#### The Trust Option

The trust option was once the most common choice for implementing a separately organized charitable program. It requires fewer organizational formalities and does not necessitate the comprehensive statutory framework for registration, meetings, filings and recordkeeping usually called for under state incorporation statutes. Trusts are, however, difficult to amend—court approval is often required for a change in purposes or trustees. Trusts are also less flexible

because trustees often lack the ability to delegate discretionary authority.<sup>180</sup> Furthermore, the trustees of a trust are not immune from personal liability for actions against the trust.

### The Corporation Option

Today, the corporation option is the most commonly used form for newly formed charities. State statutes for nonprofit corporations generally provide a comprehensive yet flexible structure. Some Indian tribes have also adopted corporation codes that include provisions for nonprofit corporations. A corporate entity generally shields those in control of the organization from corporate liabilities, except when they have been negligent in performing their duties.

### The Association Option

Although Section 501(c)(3) does not state that unincorporated associations are eligible for tax-exempt status, in practice, the IRS has given this status to such entities if they are governed by a set of bylaws or other organizational documents. The IRC does, however, specify that a "formless aggregation of individuals" is not eligible for tax-exempt status under Section 501(c)(3).<sup>181</sup>

## GOVERNING THE ORGANIZATION

Every organization needs written documents that govern how it is to be operated and by whom. Charitable organizations, regardless of their form, also need such documents. These documents are referred to as govern-

ing instruments. Indian tribes must ensure that they are aware of any and all applicable federal and state laws as they apply to governance issues.

### Common Features of Governing Instruments

Trusts, corporations and unincorporated associations need written governing instruments that spell out fundamental principles of operation. Common features of governing instruments for these types of organizations include:

- Purpose clause. Section 501(c)(3) specifies the purposes for which a charitable organization can be created. Providing a purpose clause that tracks Section 501(c)(3) language permits maximum operational flexibility. Such flexibility is desirable because needs change over time. More specific purposes may, however, give founders some ability to limit future managers from deviating from their original vision.
- Private inurement prohibition. To conform with the requirements of Section 501(c)(3), the governing instrument should state that none of the organization's earnings shall inure to the benefit of a private individual.
- Distribution on dissolution. Assets of a charitable organization cannot inure to the benefit of a private individual even after the organization dissolves. An organization may conform to this standard by naming the organizations or governmental units that qualify to receive assets upon dissolution or by permitting the directors or

<sup>180</sup> A special type of trust, called a *grantor trust*, may be appropriate for an Indian tribe that wants to form a separate legal entity without creating a separate taxable entity. A trust may qualify as a grantor trust if it exhibits one or more characteristics specified in IRC Sections 671 through 679. For example, a charitable program may be deemed a grantor trust if a grantor reserves the power to recover the funds it contributed to the trust through a power to revoke, terminate, alter or amend or to appoint. Other possible grounds for grantor trust status include reversionary interests in a grantor, the power of a grantor to dispose of the trust corpus or income without consent or approval of an adverse party, and the exercise by a grantor of certain administrative powers.

For tax purposes, all income deductions and credits are attributed directly to the grantor(s) or other persons with power over a grantor, thus a grantor trust that is funded by one or more tax-exempt Indian tribal governments should not be subject to taxation. It may also be possible for the trust to share in the tribe's tax status as an integral part of the tribe. No clear tax law precedent exists on these issues, thus, a tribe that is considering use of a grantor trust may want to seek a ruling from the IRS to confirm the trust's tax status.

If a trust established by an Indian tribe or a group of tribes is recognized by the IRS as a grantor trust, it will not be treated as a separate taxpayer and will be effectively exempt from tax. It should, however, be possible to structure a grantor trust funded by one or more Indian tribal governments such that no charitable deduction need be taken in connection with the trust so that the trust does not trigger the private foundation rules as provided in IRC § 4947.

A possible pitfall is that the trust may become subject to private foundation excise taxes if the trust is funded with any tax-deductible contributions. Thus, the grantor trust option should only be considered by tribes that intend to fund the trust exclusively from tribal revenues.

<sup>181</sup> Internal Revenue Manual, *Exempt Organizations Handbook* (7751) §§ 315.1, 315.2(3), 315.4(2).

trustees to determine which charities will receive the assets.<sup>182</sup>

- **Lobbying and political campaigning restriction.** An organization that intends to qualify for Section 501(c)(3) status should prohibit any political campaigning. Furthermore, lobbying should be limited so that it does not become a substantial part of the organization's activity.
- **Special private foundation rules.** IRC Section 508(e) states that a private foundation will not be exempted from federal income tax unless its governing instrument states that the foundation's income for each taxable year will be distributed in conformity with Section 4942 and that the foundation is prohibited from engaging in any act of self-dealing, from retaining any excess business holdings, from making jeopardy investments and from making any taxable expenditures.<sup>183</sup>

### State Law Requirements

In general, state law is inapplicable to tribal and Indian activities in Native American communities and the extent to which, if at all, state law is applicable to a tribally formed entity is a jurisdictional question beyond the scope of this manual. Thus, the applicability of state law is an issue that requires consultation with counsel. What follows is an overview of state law requirements. It does not assume that state law applies.

State statutes are likely to have specific requirements that govern trust agreements for charitable trusts. The trust agreement will typically name the original trustees who created the trust, state the trust's charitable purposes, establish guidelines for administering and distributing trust assets, set forth procedures for naming

successor trustees and state the duration of the trust.

The formation of a corporation is also governed by the specific requirements of state law. Essential elements in forming a charitable nonprofit corporation are:

- **Board of directors.** Each state has its own requirements for the minimum and maximum number of directors. To obtain certain types of public charity status, however, a charity may need to assemble a board that reflects community representation.
- **Articles of incorporation.** The organization must file articles of incorporation with the appropriate state office. In most cases, this document must contain the corporation's name and purpose, the names and addresses of the registered agent and the incorporators and procedures for dissolving the corporation and amending the articles.
- **Bylaws.** The organization must also adopt bylaws—provisions concerning the specific framework for corporate organization and operation. Generally, bylaws include provisions that govern membership (most charitable organizations do not have members), the board of directors, corporate officers, indemnification of officers and directors and procedures for amending the bylaws.
- **Organizational meeting.** The organizational meeting of the corporation will typically include the following actions: election of directors and officers, adoption of bylaws, adoption of a resolution authorizing the opening of a bank account and establishment of a fiscal year.
- **Corporate seal and minute book.** Many states

<sup>182</sup> Under current tax law, it is not clear whether, on dissolution, a tribal charitable organization with § 501(c)(3) status may direct that its assets revert directly to the Indian tribe. This is a concern that may significantly impact the organizational choice of the tribe. The source of this concern is Treas. Reg. § 1.501(c)(3)-1(b)(4), which requires that, upon dissolution of a § 501(c)(3) nonprofit, the organization's assets be distributed (by reason of the governing instruments or by operation of law) for one or more exempt purposes, to the federal government, to a state or local government for a public purpose, or by court order to an organization that will use the assets in a manner similar to the dissolved organization's use. Thus, because distribution to a tribal government is not delineated in this regulation, there is some uncertainty as to whether such an arrangement would comply with this requirement. There is, however, no principled basis to find such an arrangement as insufficient for purposes of compliance with this regulation and, in the authors' opinions, this is a matter that could be resolved by the IRS through a revenue ruling or procedure. Nevertheless, the existing uncertainty strongly suggests the need to discuss this issue with counsel before establishing the entity.

<sup>183</sup> This section is deemed satisfied if the applicable state law under which an organization is formed contains these requirements.

require that a corporation have a corporate seal and a minute book that contains the articles of incorporation, bylaws and minutes of meetings.

### Governance and Staffing

The board of directors or trustees of an organization will have the authority and responsibility to determine what the organization will do and how it will use its assets. Thus, structuring the organization's board is one of the most important elements in designing the organization. If a separate charitable organization is established, the governing body and staff of a charitable organization will be legally separate from those of the Indian tribe, even if members of the tribal government are also officers and directors of the charity. When drafting the charity's governing documents, careful consideration should be given to determining the number of directors or trustees, their qualifications and how they are selected. As with a fund, the charity's board will also want to find officers and staff who are qualified to administer their program.

If a charity intends to seek public charity status as a publicly supported charitable organization, it should be aware that the IRS may look at the composition of the board of directors to see if it reflects public involvement.<sup>184</sup> In addition, an organization that is applying for supporting organization status must meet certain requirements regarding the relation of its governing body or officers to the supported organization.<sup>185</sup>

### State or Tribal Law

A separate charitable organization can be formed under either tribal or state law. The IRC requires that a charitable organization be created in the United States under federal or state law if it is to receive deductible contri-

butions.<sup>186</sup> Although the IRS has not ruled specifically on this point, an organization formed under the law of an Indian tribe located in the United States would appear to meet this test. In addition, new IRS regulations on the classification of business entities recognize the general validity of forming corporations under tribal law.<sup>187</sup>

Nevertheless, current IRS practice shows a bias in favor of charitable organizations that are formed under state law. More specifically, forming under state law presents the IRS with a familiar structure to evaluate. In all likelihood, the IRS agent reviewing a tribal organization's application for exemption will not be familiar with tribal law, which may delay approval of the application. Moreover, some IRS reviewers interpret Section 170(c)(2) as a requirement to form under state law.<sup>188</sup>

Despite these "conveniences," the consequences of forming under state law, including the substantial limits that such a choice imposes on tribal authority, must be carefully considered. For example, if formed as a state-law corporation, the organization will be subject to the requirements of the state nonprofit corporations statute, which may set specific parameters for membership, directors, annual reports and challenges to corporate action. As a trust, the organization may also be subject to the state's common law *cy pres* doctrine, which permits a change in the purpose for which assets are placed in a charitable trust only under limited circumstances.<sup>189</sup>

In addition, the state attorney general has general review and oversight responsibility over an organization formed under state law, including the authority to bring an action against a charity if it has committed illegal actions, has fraudulently abused its charitable status or has otherwise acted in a way that is inconsistent with the charitable purposes expressed in its governing docu-

<sup>184</sup> Treas. Reg. § 1.509(a)-3(d)(2).

<sup>185</sup> Treas. Reg. § 1.509(a)-4(f)-(i).

<sup>186</sup> See IRC § 170(c)(2).

<sup>187</sup> Treasury regulations define the kinds of business entities that will be treated as corporations and explicitly include corporations formed "...under a statute of a federally recognized Indian tribe" Treas. Reg. § 1.7701-2(b)(1). The overall purpose of these so-called "check-the-box" regulations is to simplify the formation of business entities.

<sup>188</sup> See note 115.

<sup>189</sup> The term *cy pres* literally means "close by." Under this doctrine, a charity can modify the terms of a gift only if fulfilling the donor's original intent is or becomes illegal, impossible or impractical. Application of the doctrine varies from jurisdiction to jurisdiction. See Bogert, *The Law of Trusts and Trustees*, §§ 438ff (1991, 1996, Rev. 2d ed.).

ments. If a court finds that a charity has violated its status by acting improperly, it can issue an injunction to stop the improper actions, and in some cases may dissolve the organization and distribute its assets in accordance with the procedures established by state law. Possible grounds for judicial dissolution include obtaining a certificate of incorporation through fraud, exceeding or abusing the authority conferred by law or continuing to violate the law following notice of such violation, failing to respond to inquiries by the state, fraudulently soliciting money or fraudulently or improperly using donations. In sum, an entity organized under state law is subject to state control.

In most cases, a charitable grantmaking corporation that has been funded primarily with tribal revenues will want to organize under tribal law. If the entity does organize under tribal law, it need not do so as a traditional corporation. The new IRS entity classification regulations state that any organization that claims exempt status will be deemed to be an association (and hence a corporation) for federal tax purposes.<sup>190</sup> Thus, an organization incorporated under tribal law need not exhibit the core characteristics that traditionally defined the corporate form, such as associates, an objective for its participants to implement, centralized management, limited liability, continuity of life and the free transferability of interests.

A tribal entity organized under state law may subsequently be able to organize under tribal law (or vice versa)—subject to certain conditions. In such an instance, the entity should dissolve in accordance with the law under which it was initially formed in order to avoid having to continue to be subject to the legal regime of both jurisdictions. Moreover, if the entity has obtained tax-exempt status from the IRS, the entity must report the change in organizational form to the IRS.

## **EARLY DECISIONS IN STARTING A GRANTMAKING PROGRAM**

An early decision for an Indian tribe interested in starting up a charitable giving organization is whether it will be administered directly by the Indian tribe or operated as a separate foundation. Although different issues surround each of these choices, many of the operational requirements of unincorporated funds apply equally to charitable organizations structured as separate entities.

### **Unincorporated Funds/Giving Programs**

Establishing a specific fund for charitable giving purposes, assigning appropriate staff and adopting grantmaking procedures are basic requirements for unincorporated and separate charitable entities alike.

### **Establishing a Restricted Fund**

If an Indian tribe plans to administer its giving program through a tribal or tribal enterprise giving program that is not separately organized, it may wish to establish a restricted fund that is dedicated to the identified charitable purposes. The Indian tribe may decide to adopt written guidelines for administering the fund through, for example, a resolution of the tribal council or the board of the tribal enterprise.<sup>191</sup>

### **Staffing**

Fund activities, such as processing grant applications and distributing grants, can be facilitated by assigning or hiring staff dedicated to day-to-day program management. A special committee of the Indian tribe or tribal enterprise's governing body could also be appointed to oversee the fund's activity.

### **Grantmaking Procedures**

Establishing formal grantmaking procedures that define the type of programs the fund intends to support will help potential beneficiaries and the grant selection team. Once grantmaking guidelines have been defined,

<sup>190</sup> Treas. Reg. § 1.7701-3(c)(1)(v)(A).

<sup>191</sup> See Appendix D, Sample Document 1 (sample tribal resolution creating a restricted charitable fund).

grantseekers who are outside the scope of the fund's interests are less likely to apply and those who do will focus their applications on meeting those guidelines. Published grantmaking procedures will also provide a structured basis for making and explaining grant decisions.

Key grantmaking procedures for both unincorporated tribal giving programs and separately organized tribal foundations include:

- **Written guidelines.** Written guidelines help potential beneficiaries decide whether to apply and how to structure their grant proposals. Guidelines should provide a brief description of the giving program, eligibility requirements and criteria, deadlines, limits (if any) on how many proposals can be submitted, application procedures, information to include in an application, required supporting documentation and notification procedures.
- **Generating grant proposals.** Publicizing a giving program increases chances of finding grantees that are best suited to achieve the objectives of the Indian tribe's plan or vision. Researching the areas in which the Indian tribe intends to provide assistance, and the practices of other grantmakers, may help in developing strategies for publicizing grantmaking activities.
- **Screening and reviewing grant proposals.** The Indian tribe can determine who will review grant requests and under what objective criteria grant proposals will be assessed. Most organizations delegate initial screening and assessment to a grant review committee.
- **Determining grant amount and duration.** The Indian tribe—not the grantseeker—determines how much support it will provide and for how long support will be provided. To facilitate these decisions, the giving program may find it useful to establish criteria and procedures for assessing a grantseeker's financial state, its needs for a particular project and the extent to which the fund will provide useful support.

- **Grants vs. loans.** The Indian tribe can determine whether its support will be in the form of grants or loans and establish procedures for accounting for the type of support it will provide.
- **Presentation to board/committee.** Once a set of prospective grantees has been selected, a formal procedure by which the appropriate governing body reviews and approves grants is required.
- **Monitoring and post-grant evaluation.** Reporting and oversight procedures are recommended to ensure that grantees use funds in accordance with their intended purpose. Post-grant evaluation procedures will also help the Indian tribe to find ways to improve its grant-making program.
- **Communications and public information.** A well-designed public information program can increase public confidence in the fund and help to make it a visible and active presence in tribal life.

## EARLY DECISIONS FOR A GRANTSEEKING ORGANIZATION

For most unendowed organizations or those without a regular donor such as a tribal enterprise, fundraising is a critical issue; future charitable operations will depend on success in this area. Thus developing a fundraising plan early—before seeking 501(c)(3) recognition or 7871 status—is important.

Whether funding comes from individuals, corporations or foundations, to succeed in fundraising, the organization must meet donor expectations. Donors almost always have views on how their donations should be spent and consider it important to know whether such donations are tax deductible. The IRS has different rules for the different types of donations (for instance, cash and property), as well as the various types of donors (individuals or corporations) and donees (public charities, private foundations or governmental entities). Organizations that seek funding must under-

stand the tax consequences of the donation—for the donor and donee as well—to meet donors' expectations. (See below for a discussion of charitable donations.)

### Developing a Fundraising Plan

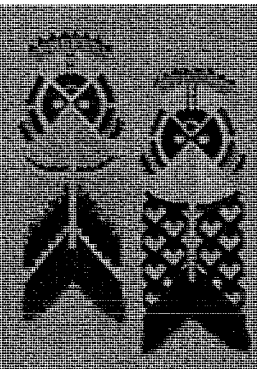
The most common forms of fundraising<sup>192</sup> are direct mail solicitation, telephone and television campaigns and special benefit events. There are, however, many others. For instance, support group organizations sometimes give a portion of their membership dues to a charitable organization or sponsor fundraising events. Donor clubs and associations often recognize and honor substantial contributors at fundraisers, which generate further contributions. Moreover, members of fundraising campaign committees make contributions themselves and then contact others—friends, business associates or relatives—to solicit their support for the organization. In this way, the circle of donors grows, becomes more diverse and provides a funding base.

### Types of Donations

Donations can come in many different forms, giving donors several choices. These forms include:

- gifts from a donor to commemorate a special lifetime occasion or in memory of a family member or associate,
- donations in the form of goods, services or advertising space in publications,
- donations from the general public by making door-to-door or on-street solicitations,
- grants from other charitable organizations,
- special fundraising events, such as a Monte Carlo night—if permitted by applicable law,
- annual campaigns, which solicit donations to benefit all community organizations,
- campaigns or one-time fundraising drives to benefit a particular project such as the construction, rehabilitation or acquisition of buildings or other large capital items,
- planned giving arrangements, which range from a simple bequest in a will to more complex arrangements,
- pooled income funds, a method by which individuals contribute cash or other property to a pool that contains the contributions of other donors,<sup>193</sup> and
- charitable remainder trusts—funds that, although donated to a charity, continue to support the donor.<sup>194</sup>

**T**he American Indian College Fund was launched in 1969 as a Section 501(c)(3) public charity. The mission of the fund is to raise funds from individuals, corporations and foundations for scholarships to students at tribal colleges. Donations are also used to fund the developmental needs of the colleges and to increase public awareness of the work of tribal colleges. More than \$3 million was distributed to 30 colleges and their students in 1997. The funds were raised from individual donations, grants, a gala dinner and the sale of products, such as "Hope Series" blankets designed by Native American artists.<sup>195</sup>



<sup>192</sup> See Bruce Hopkins, *The Law of Fundraising* (hereinafter *The Law of Fund-Raising*), § 2.2, pp. 24–31 and The Fundraising School and Native Americans in Philanthropy, Principles and Techniques of Fund-Raising for Native American Organizations and Constituencies (hereinafter NAP, *Principles and Techniques*).

<sup>193</sup> In a pooled income fund, interest on the principal is paid out to donors on a pro rata basis until their death. At that time, the principal contribution is paid over to the charity.

<sup>194</sup> In a charitable remainder trust, the trustee invests the donation and pays income to the donor during his or her lifetime. When the donor dies, the principal and accrued interest not paid out are transferred to the charity. The IRC only allows charitable remainder agreements in the form of a unitrust, annuity trust or gift annuity.

<sup>195</sup> Source: Material supplied by the American Indian College Fund.



In developing a fundraising plan, an organization must consider what kinds of donors to seek and what forms of gifts may be attractive to the donors it pursues. These decisions are, of course, informed by the unique characteristics and circumstances of an organization—its location, size, directors and officers, service community, goals and purposes, which in turn have a role in determining what fundraising methods are used.

### **Tax Laws and Charitable Donations**

Federal and state tax laws on charitable donations are quite specific. Table 1 provides an overview of the laws that affect donations by living donors to various types of charitable organizations. Descriptions of laws governing different types of donations, by a variety of donors, follow.

#### **Donations from Individuals**

IRC Section 170 generally allows taxpayers to reduce their taxable income by the amount of charitable contributions made in the tax year. Donations of cash and other property, but not services, to governmental units, public charities and private foundations are allowed as charitable deductions. Expenditures for which a taxpayer is not reimbursed, and which are incidental to the donation of services, may also be deductible.<sup>196</sup>

For individuals, the limit on cash contributions to public charities or governmental units is 50 percent of the individual's annual adjusted gross income (AGI).<sup>197</sup> Gifts in excess of that amount can be carried forward as deductions for the succeeding five tax years.<sup>198</sup> For example, if an individual donates \$10,000 to a tribal government or a tribal 501(c)(3) organization with pub-

lic charity status, and the individual's AGI for the year is \$15,000, that individual could deduct \$7,500 from his or her taxable income in the year of the donation. The donor could carry forward the excess \$2,500 to the next tax year and use it as a deduction subject to the 50 percent AGI limitation.<sup>199</sup>

Individuals can also deduct capital gain property donations to public institutions and public charities in amounts up to 30 percent of AGI.<sup>200</sup> Such property includes long-term capital gain property, such as stocks, bonds, land and valuable paintings or manuscripts.<sup>201</sup> For example, an individual who donates stock to a tribal government or a tribal 501(c)(3) organization with public charity status can deduct from his or her taxable income the fair market value of the stock in an amount up to 30 percent of his or her AGI. If the stock is worth \$1,000 and the individual's AGI is \$1,500, the individual's taxable income could be reduced by \$450. The remaining \$550 can be deducted in the succeeding five years subject to the 30 percent AGI limitation.<sup>202</sup>

The rules are more strict for contributions to private foundations. In general, individuals can deduct cash contributions to private foundations in an amount equal to the lesser of 30 percent of their AGI or 50 percent of AGI less charitable contributions to public institutions, public charities and certain private foundations.<sup>203</sup> Excess amounts are deductible in the succeeding five years (again, subject to the 30 percent AGI limit).<sup>204</sup> When such donations involve capital gain property, the limit is the lesser of 20 percent of the individual's AGI or 30 percent of AGI less contributions of capital gains property to public institutions, public charities and certain private foundations.<sup>205</sup> A donor can, however, deduct the full fair-market value of

<sup>196</sup> Treas. Reg. § 1.170A-1(g).

<sup>197</sup> IRC § 170(b)(1)(A).

<sup>198</sup> IRC § 170(d)(1).

<sup>199</sup> Discussion of the carryover of excess contribution rules in § 170(d)(1) & (2) is beyond the scope of this manual.

<sup>200</sup> IRC § 170(b)(1)(C). Capital gain property is property described in § 1221 and in general includes investment property, not property used by a taxpayer for purposes of generating income in a business. For purposes of these types of donations (individual donations of capital gain property), however, capital gain property also includes any property used in a trade or business as defined in § 1231(b). This provision brings within the definition of capital gains property depreciable property used in a trade or business and held for more than one year. § 170(b)(1)(C)(iv).

<sup>201</sup> IRC § 170(b)(1)(C)(iv).

<sup>202</sup> IRC § 170(b)(1)(C)(ii) and § 170(d)(1).

<sup>203</sup> IRC § 170(b)(1)(B).

<sup>204</sup> Id. and § 170(d)(1).

<sup>205</sup> IRC § 170(b)(1)(D).

**TABLE 1****Public Charities and Private Foundations: Effects of Selected Tax Laws on Donors**

<b>LAWS AFFECTING LIVING DONORS</b>	<b>TRIBAL FOUNDATION</b>	<b>TRIBAL ENTERPRISE FOUNDATION</b>	<b>CONDUIT FOUNDATION</b>	<b>POOLED COMMON FUND</b>	<b>OPERATING FOUNDATION</b>
Cash Gift Limits	30% AGI	10% Taxable Income (Corp.) 30% AGI (Ind.)	50% AGI	50% AGI	50% AGI
Appreciated Property	20% AGI	10% Taxable Income (Corp.) 20% AGI (Ind.)	30% AGI	30% AGI	30% AGI
Carryover Available <sup>a</sup>	5 years	5 years	5 years	5 years	5 years
Value of Appreciated Property	Fair Market Value for Publicly Traded Stock <sup>b</sup> , Otherwise, Cost Only	Fair Market Value for Publicly Traded Stock <sup>b</sup> , Otherwise, Cost Only	Fair Market Value	Fair Market Value	Fair Market Value

<b>LAWS AFFECTING LIVING DONORS</b>	<b>TRADITIONAL CHARITY 509(a)(1) INCLUDING COMMUNITY FOUNDATIONS)</b>	<b>GROSS RECEIPTS CHARITY 509(a)(2)</b>	<b>SUPPORTING ORGANIZATION 509(a)(3)</b>
Cash Gift Limits	50% AGI	50% AGI	50% AGI
Appreciated Property Limits	30% AGI	30% AGI	30% AGI
Carryover Available	5 years	5 years	5 years
Value of Appreciated Property	Fair Market Value	Fair Market Value	Fair Market Value

Note: Table adapted from First Steps in Starting a Foundation, 4th ed., Council on Foundations, 1997.

<sup>a</sup> Carryover refers to the ability of donors to carry forward into future tax years amounts not deductible in the year a gift is made because those amounts exceed the applicable percentage of a donor's adjusted gross income.

<sup>b</sup> Subject to possible extension by Congress, fair market value deductibility for gifts of publicly traded stocks expired June 30, 1998.

AGI = Adjusted Gross Income; Corp. = Corporation; Ind. = Individual

property given to a private foundation if the gift is publicly traded stock.<sup>206</sup> Otherwise, the donor can deduct only the cost of the gifted property, not its appreciated value.<sup>207</sup> Excess amounts may be carried forward in the succeeding five years.<sup>208</sup>

In calculating the amount of his or her charitable contribution deduction, a donor must determine whether he or she can use the cost basis of the property—normally the amount he or she paid for the property—or the fair market or appreciated value of the property. This calculation is distinct from the percentage of AGI calculation, but before a donor makes that determination, he or she must know the amount of the charitable contribution. In most cases, this calculation is simple. For example, if a donor contributes cash, he or she can deduct the full amount of the cash donated, subject to the AGI limitations discussed above. In the case of noncash contributions, such as contributions of tangible property, the rules are more complex.

When a taxpayer makes lifetime gifts or bequests in a will, he or she is liable for a gift tax and/or the taxpayer's estate is liable for estate tax. When computing gift or estate tax liability, however, certain types of gifts and bequests are deductible. For example:

- Sections 2055 and 2106 allow deductions against the taxable estate for donations to domestic governments, Section 501(c)(3)-type corporations, charitable trusts, fraternal organizations and veterans' organizations.
- Section 2522 allows deductions against taxable gifts for gifts to organizations described above.

- Section 642 allows unlimited deductions against taxable trust and estate income for donations made for purposes specified in Section 170(c).

In addition, Section 7871 applies some of these rules to gifts and bequests made to qualified tribal governments.<sup>209</sup> Thus, a tribal government that the IRS recognized as such under Section 7871 can receive donations that are deductible against the taxable estate of the decedent and exempt from gift tax. Donors and potential donors should be informed that special rules apply to partial or remainder interests that are gifted or bequest as charitable contributions.

As noted above, an organization should always advise donors to retain their own counsel or other tax advisor to determine the tax effect of any particular donation.

### Donations from Corporations

In a given taxable year, a corporation can deduct charitable contributions of cash or appreciated property totaling up to 10 percent of its pretax income.<sup>210</sup> Excess amounts can be carried forward to the succeeding five years.<sup>211</sup>

Corporations that make donations to public charities and private operating foundations are subject to special charitable contribution deduction rules for certain donations of inventory property.<sup>212</sup> To maximize a donor's deductions, the recipient of donated inventory must use the property for a purpose related to its tax-exempt status. The donee must also use the property solely for the care of the ill, the needy or infants (defined as minors).<sup>213</sup> For example, a contribution of

<sup>206</sup> See IRC § 170(e)(5). This provision expired on June 30, 1998. Future extensions are unknown at this time.

<sup>207</sup> IRC §§ 170(e)(1)(B)(ii), 170(e)(5). This publicly traded stock exception expired on June 30, 1998, but may be extended again in the future.

<sup>208</sup> IRC § 170(b)(1)(D)(ii) and (d)(1).

<sup>209</sup> IRC § 7871(a)(1)(B) and (C).

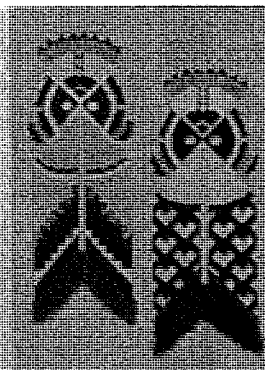
<sup>210</sup> IRC § 170(b)(2).

<sup>211</sup> IRC § 170(d)(2).

<sup>212</sup> IRC § 170(e)(3).

<sup>213</sup> Treas. Reg. § 1.170A-4A(b)(2)(ii)(D) defines an infant as a minor child as determined by the law of the jurisdiction of residence. Care of the needy is defined as care that relieves an existing need. Care of an infant is defined as the performance of a parental function and/or provisions for physical, mental or emotional needs.

**F**ounded in 1970, the Native American Rights Fund (NARF) is a 501(c)(3) publicly supported organization devoted to achieving justice for Native Americans under the rights guaranteed by existing United States laws and treaties. NARF receives financial support from foundations, corporations, Indian tribes, Indian organizations, government agencies, individual contributions (direct mail, memorial and planned giving, workplace giving, major gifts) and special events. NARF has also established a 21st Century Endowment Fund intended to help ensure the future of the organization. Funds for the endowment will be raised from individual, corporate and foundation contributions. NARF provides legal advice and representation to Indian tribes, individuals and organizations nationwide in the areas of preservation of tribal existence, protection of tribal natural resources, promotion of human rights, accountability of governments to Native Americans and the development of Indian law. Its principal office is in Boulder, Colorado, with satellite locations in Washington, D.C., and Anchorage, Alaska.<sup>214</sup>



books to an Indian organization for use by young Native Americans of high school age or younger may qualify a corporate donor for special treatment in calculating the amount of its charitable contribution.<sup>215</sup>

Under a provision passed in 1997, donations of qualified computer technology and equipment for elementary or secondary school purposes also affords a corporation a larger charitable contribution deduction.<sup>216</sup> For instance, a corporation that donates qualified computer software to a tribal elementary school might be able to take advantage of the increased charitable contribution deduction.

### Special Rules for Other Types of Property

Special rules also govern the deductibility of certain kinds of property. For example, special tax rules exist for donations of future<sup>217</sup> or partial interests in property,<sup>218</sup> scientific property used for research,<sup>219</sup> property placed in trust<sup>220</sup> and qualified conservation interests.<sup>221</sup> A

description of these rules is beyond the scope of this document. As noted above, deductions against gift and estate tax liability are also available to taxpayers who make contributions to certain types of organizations.

### Seeking Funds from Foundations and Charities

Available resources are limited in many reservation communities. In some cases, the best opportunity for assisting charitable or social welfare projects may be funding from private foundations and other grantmaking organizations located off-reservation.

Obtaining this type of funding normally requires preparing and submitting a grant application. Grant applications and the information they require varies from grantmaker to grantmaker. Meeting the requirements of the grantmaker is essential in preparing an effective grant request. A grantseeker must ensure that its request describes the purposes, goals and activities for which funding is sought. The grant request should

<sup>214</sup> Source: Material supplied by NARF.

<sup>215</sup> In Priv. Ltr. Rul. 9621005 (Apr. 29, 1996), the IRS ruled that a donation of books to young Native Americans did *not* meet the requirements of § 170(e)(3) because the donor failed to show that the books were used solely for minors. Some of the donated books apparently were used by college-aged persons.

<sup>216</sup> Taxpayer Relief Act of 1997, Pub. No. 105-34, § 224, reprinted in 1997 U.S.C.A.N. (111 Stat.) 818.

<sup>217</sup> IRC § 170(f)(4).

<sup>218</sup> IRC § 170(f)(3).

<sup>219</sup> IRC § 170(e)(4).

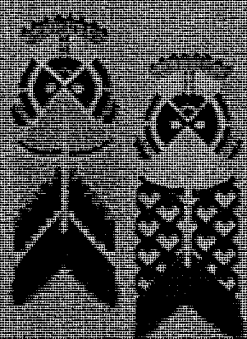
<sup>220</sup> IRC § 170(f)(2).

<sup>221</sup> IRC § 170(h).

also indicate the amount of funding being sought and the total cost of the proposed activity or project for the grant period. A grant request is an opportunity for an organization to describe its goals and how the grant will promote these goals. The grantseeking organization must then demonstrate how it is qualified to implement the program to be funded, based on its historical activities, financial status and other factors.

Additional specific information may be required in a grant request. For example, a private foundation typically requires a copy of the organization's tax-exempt determination letter—that is proof of 501(c)(3) status—its annual information return (IRS Form 990) or other

financial statement, a list of the organization's officers, resumes of key staff and a list of current corporate and foundation contributors.<sup>222</sup> A tribal organization is not necessarily required to file a Form 990,<sup>223</sup> but may choose to do so or to prepare annual reports on its activities and finances that are equivalent in scope and detail to the Form 990, as a tool for grantseeking. A tribal government organization that has been recognized by the IRS under Section 7871 may also wish to apprise the grantmaker of such status.



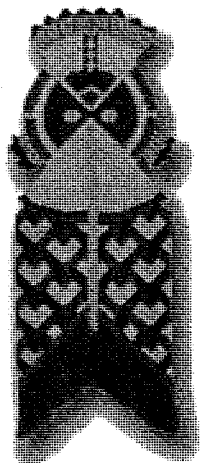
**T**he Seventh Generation Fund for Indian Development was founded in 1977 as a Section 501(c)(3) public charity incorporated in Arcata, California. It provides resources to Indian people to facilitate self-help efforts and to promote positive change in Indian communities. The fund provides technical and training assistance and makes grants for economic renewal in Indian communities, cultural preservation and religious freedom projects and environmental initiatives. For instance, a grant to the Hopi Foundation supported a project to install solar panels in Hopi villages as an alternative to outside sources of electric power. The fund has established a small endowment to produce income for its activities. Funds for the endowment are generated from the private sector and other public charities.<sup>224</sup>

<sup>222</sup> Numerous sources provide advice on grantwriting. See, for example The Foundation Center, *Guide to Proposal Writing* (1997).

<sup>223</sup> See Chapter 6 discussion under "Ongoing Compliance Considerations."

<sup>224</sup> Source: Material supplied by the Seventh Generation Fund for Indian Development.

## CHAPTER SIX



# OBTAINING TAX-EXEMPT STATUS AND ONGOING COMPLIANCE WITH FEDERAL AND STATE REGULATIONS

**M**uch of the effort of establishing and operating a tribal grantmaking or grantseeking organization will involve staff, legal counsel and the individuals or organizations that will be served by or provide support to the charity. As important as these efforts are, however, ensuring that the proper forms are filed on time, and that all of the information provided is accurate, can mean the difference between timely completion and a protracted Section 501(c)(3) charitable organization recognition process. Likewise, care must be taken in preparing a private letter ruling request for recognition of Section 7871 treatment for a tribal government and/or its associated governmental units. In addition, being aware of and complying with federal, tribal and state reporting requirements today can prevent legal problems in the future.

### APPLYING FOR TAX-EXEMPT OR TRIBAL GOVERNMENT STATUS

Of the two options for obtaining tax-favored status, applying for recognition as a Section 501(c)(3) entity requires the most effort, but a private letter ruling under Section 7871 may be more expensive. This chapter describes the process by which an Indian tribe, tribal subdivision or integral part of an Indian tribe receives IRS confirmation of its status under Section 7871 and the process for requesting recognition as a Section 501(c)(3) charitable organization.

#### Securing Recognition of Section 7871 Status

Before a tribal entity seeks tax-deductible donations, it must determine whether it is listed in either the 1983 or 1984 IRS Revenue Procedures, which lists qualified Indian tribal governments and their political subdivisions for purposes of Section 7871.<sup>225</sup> If it is not, a request for a private letter ruling confirming its status as a qualified Indian tribal government (or political subdivision thereof) must be submitted to the IRS.<sup>226</sup>

<sup>225</sup> Rev. Proc. 83-87, 1983-2 C.B. 607 and Rev. Proc. 84-36, 1984-1 C.B. 510.

<sup>226</sup> Rev. Proc. 84-37, 1984-1 C.B. 513, explains the procedure for requesting a private letter ruling confirming treatment as a state status under 26 U.S.C. § 7871.

### *General Requirements*

Revenue Procedure 84-37. For purposes of obtaining a private letter ruling from the IRS confirming the tax status of a tribal government or political subdivision under Section 7871, Rev. Proc. 84-37 requires that the requesting entity provide certain information:

- The request for the private letter ruling should first indicate how the requesting entity satisfies the statutory definition of an Indian tribal government. (Section 7701(a)(40) defines an Indian tribal government as the governing body of any Indian tribe determined by the Secretary of the Treasury to exercise governmental functions.)
- The ruling request should include the date the requesting entity satisfied the definition under Section 7701(a)(40) or was delegated sovereign powers by the tribal government.<sup>227</sup>

The IRS will make its determination "based on all the facts and circumstances" and the ruling request should be "sufficiently detailed to show...that the entity in question qualifies as a governmental unit of an Indian tribe or a political subdivision...."<sup>228</sup>

**Revenue Procedure 98-1.** The IRS provides additional guidance related to requests for private letter rulings each year in a revenue procedure issued in January.<sup>229</sup>

According to the 1998 procedure, a request for a private letter ruling must include identifying information such as the organization's name, address, phone numbers, the name of the IRS district office with examination jurisdiction over the tribal government and copies of relevant contracts—for instance, Section 638 self-determination contracts related to the functions of the governmental unit/agency. In the case of a tribal government, it should include any material facts and statutory authority (including tribal law), and other

information that may be relevant. If the requestor wants to preserve the confidentiality of the IRS ruling, it should also submit a deletions statement to guide the IRS in deleting proper names and other identifying material. The entity requesting the ruling must include a user fee with the request. Currently, the IRS charges \$3,650 per request for private letter rulings.

If the ruling request is properly prepared and submitted, Section 7871 status should be relatively easy to obtain. Assistance of counsel is highly recommended.

### *Specific Requirements*

**Governing body of a tribal government.** When a tribal government requests a private letter ruling, it must demonstrate that it meets the definition of an Indian tribal government under Section 7701(a)(40).<sup>230</sup> The IRS makes its determination in consultation with the Interior Department. Thus, the request should indicate whether the Indian tribe is listed in the Federal Register by the Secretary of the Interior as a federally recognized Indian tribe entitled to receive funding and services from the federal government. The request should enumerate the sovereign powers exercised by the Indian tribe, such as the power to tax, police powers and the power of eminent domain.<sup>231</sup> If a tribal government is federally recognized by the Interior Department, this part of the private letter ruling request should be relatively straightforward.

**Subdivision of tribal government.** If a subdivision of a tribal government seeks recognition under Section 7871, it must show that the tribal government has delegated sovereign powers—the power to tax, police power or the power of eminent domain—to the subdivision. The legislative history to Section 7871 indicates that the subdivision need not in fact exercise the power "at any given time, so long as the Indian tribal government has in fact delegated to the subdivision the right to

<sup>227</sup> Sovereign powers include the power to tax, the power of eminent domain and police powers.

<sup>228</sup> Rev. Proc. 84-37 1984-1 C. B. 513-514.

<sup>229</sup> Rev. Proc. 98-1, 1998-1 I.R.B. 7.

<sup>230</sup> IRC § 7701(a)(40) defines an Indian tribal government as the governing body of a tribe, band, community, village or group of Indians or Alaska Natives as determined by the Secretary of the Treasury after consultation with the Secretary of the Interior, to exercise governmental powers.

<sup>231</sup> Priv. Ltr. Rul. 9644034 (July 30, 1996) is an example of a ruling recognizing a tribal government as eligible for § 7871 status.

exercise the power.”<sup>232</sup> Furthermore, the IRS must apply essentially equivalent criteria to tribal governments as it does to state governments “in making the determination regarding the status of their political subdivisions.”<sup>233</sup> In at least one instance, the IRS has recognized an intertribal agency as a political subdivision.<sup>234</sup>

### **Applying for Recognition of Charitable Status under Section 501(c)(3)**

Most charitable organizations described under Section 501(c)(3) must apply to the IRS for recognition of their tax-exempt status<sup>235</sup> using Form 1023.<sup>236</sup> Extreme care must be taken in preparing this form because it serves as the basis for the recognition or denial of tax-exempt status and the issuance of an advance ruling on public charity status. In addition, if tax-exempt status is granted, the form must be made available for public inspection during the organization’s regular business hours. In the near future, public charities will be required to provide copies of Form 1023 and any attachments to anyone who requests them in person or by mail. To prevent both legal and public relations problems, tribal leaders and their counsel should ensure that the information provided in Form 1023 is accurate, complete and consistent.

#### ***Completing the Form 1023***

Completing Form 1023 requires that the IRS be supplied with copies of the charity’s organizing instruments—articles and bylaws or trust agreement—as well

as information on funding sources, activities, the governing body and any relationships that it may have with other organizations. Even if the organization has yet to begin operations, the information provided should be as detailed as possible so that IRS review proceeds as quickly as possible. Form 1023 also requires that applying entities submit budget projections. Although the organization is not bound to follow the submitted budget exactly, the budget should accurately reflect its plans.

Organizations that seek public charity status can obtain an advance ruling on their application. Under such a ruling, the IRS treats the entity as a public charity for five years to give it the time necessary to obtain sufficient public support.<sup>237</sup> Within 90 days after the end of that five-year period, the organization must file papers to show that it has attracted sufficient public support.<sup>238</sup> If it fails to do so, it is reclassified as a private foundation and made liable for the excise tax on investment income retroactively. Donors who made tax deductible contributions during the advance-ruling period are not, however, affected by the organization’s change in status. In most instances, an IRS determination that an organization is a private foundation is a final ruling—the ruling can, however, be modified if subsequent changes in operation occur. A Section 501(c)(3) organization that fails to notify the IRS otherwise is presumed to be a private foundation.<sup>239</sup>

Organizations must generally apply for tax-exempt status within 15 months from the end of the month in which they were formed. In many cases, however, the organization is eligible for an automatic 12-month

<sup>232</sup> S. Rep. No. 646, 97th Congress, 2d Sess. 12, reprinted in 1982 U.S.C.A.N. 4590 (1982).

<sup>233</sup> *Id.* See Priv. Ltr. Rul. 9711025 (Dec. 13, 1996) for an example of a ruling that a subdivision qualifies under § 7871. It appears that a subdivision will be recognized as eligible under § 7871 even if the tribal government has not requested a ruling on its § 7871 status, although the tribal government must meet the definition under § 7701(a)(40) to qualify its subdivisions.

<sup>234</sup> Priv. Ltr. Rul. 9409031 (Dec. 7, 1993) ruled that an intertribal organization formed by twelve Tribes to administer governmental programs on their behalf constituted a political subdivision of 11 of the 12 tribes involved. See Chapter 1 for a discussion of Section 7871 status for integral parts of a tribal government.

<sup>235</sup> IRC § 508(a). Churches or other § 501(c)(3) organizations that are not private foundations with gross receipts of less than \$5,000 for the tax year need not apply for recognition of tax-exempt status to be tax-exempt under § 501. § 508(c)(1)(A)&(B).

<sup>236</sup> See generally, Hopkins, *A Legal Guide to Starting and Managing a Nonprofit Organization*, chapter 6 (1993). This book provides an excellent and highly readable guide to starting a nonprofit organization.

<sup>237</sup> Treas. Reg. § 1.509(a)-3(d)(1) and (4). Section 1.509(a)-3(d)(4) allows an organization to extend the initial two-year advance ruling period for an additional three years under certain circumstances.

<sup>238</sup> Treas. Reg. § 1.509(a)-3(e)(2).

<sup>239</sup> IRC § 508(b).



extension.<sup>240</sup> If an organization files within the requisite period, the effective date of tax-exempt status will become the date on which the organization was founded. Otherwise, the effective date of the exemption is the date when the Form 1023 was filed.<sup>241</sup>

When an organization's Form 1023 is approved, the IRS sends a determination letter stating that tax-exempt status has been recognized and specifying whether the entity has been classified as a public charity or private foundation.

### *Specific Requirements of Form 1023*

**Part I: Identifying information.** Part I of Form 1023 asks for identifying information including:

- name and address of the organization and the organization's employer identification number,
- name of the contact person,
- organization's accounting period, that is, whether the organization's budget will be based on a fiscal or calendar tax year,
- organization's date of creation (if the organization is a corporation, this date will be its date of incorporation; otherwise, the date will be its creation date as indicated in its governing documents),
- activities that indicate the organization's purposes, activities or type, and
- organization's legal form. The appropriate governing documents should accompany the application.

Whether the organization is required to file a Form 990 (Annual Information Return) is a separate question. Some tribal government-controlled 501(c)(3) organizations need not file Form 990. Additionally, in a recent administrative pronouncement, Revenue

Procedure 95-48, the IRS indicated that Section 501(c)(3) organizations that are formed by and accountable to a tribal or other governmental body are exempt from filing Form 990.<sup>242</sup> If a tribal organization believes that it qualifies for such a reporting exemption, it should attach a statement to Form 1023 explaining in detail how it meets the criteria set forth in Revenue Procedure 95-48.<sup>243</sup>

### **Part II: Purpose, activities and funding sources.**

Part II of the form is very important because it asks the organization to provide information on why it is entitled to tax-exempt status. In this part, the organization has an opportunity to explain its charitable activities. It is also required to identify its sources of financial support and fundraising programs, the names and addresses of the organization's officers and directors with information on the annual compensation of such persons,<sup>244</sup> the extent and nature of the organization's relationship with other entities, and whether the organization provides services for a fee and the nature of these services and fees.

**Part III: Public charity classification.** How an organization responds to questions in Part III determines whether it is classified as a public charity or a private foundation. A new organization seeking an advance ruling of public charity status must demonstrate that it will receive public support in an amount that would satisfy one of the public support tests described in Chapter 2. The proposed budget will contain the information necessary to evaluate whether the organization meets one of these tests.

**Form 1023 schedules.** Schedules A through I request information from particular types of organizations or from organizations that plan to administer certain types of programs. Private foundations and supporting organizations must provide additional information on such forms to justify their status. Private operating foundations must demonstrate that they meet the

<sup>240</sup> Rev. Proc. 92-85, 1992-2 C.B. 490.

<sup>241</sup> Rev. Proc. 84-47, 1984-1 C.B. 545.

<sup>242</sup> See also *supra* Chapter 4.

<sup>243</sup> Rev. Proc. 95-48, 1995-2 C.B. 418.

<sup>244</sup> An organization may violate the private inurement prohibition if it provides an employee with compensation that the IRS considers excessive based on comparisons with similar positions at similar organizations. The Council on Foundations has information on comparable salaries for employees of grantmaking foundations.

income test and one of the assets, endowment or support tests. Organizations that will provide scholarships to individuals must describe the nature of their student aid program.

**Miscellaneous forms.** An organization looking for an advance ruling of public charity status must execute Form 872-C. This form is included with Form 1023 and, if approved by the IRS, constitutes a waiver of the statute of limitations for collecting certain taxes. This waiver allows the IRS to assess the private foundation excise taxes for each year of the advance ruling period if the organization fails to qualify for public charity status at the expiration of that period.

Every applicant must obtain an employer identification number by filing IRS Form SS-4 prior to or at the same time it files Form 1023—even if it has no employees. If an independent representative—an outside accountant or attorney, for example—will be the contact person, the organization must submit Form 2848, which gives the representative power of attorney to act on behalf of the organization and to deal directly with the IRS.

#### *Ongoing Filing Requirements*

Once tax-exempt status has been recognized, an organization must meet annual federal, tribal (to the extent applicable) and state information filing requirements. Additionally, if the organization has unrelated business income, it must file a return and pay federal tax on that income. Most states also impose annual filing obligations on organizations that are exempt from state income tax: some impose a state unrelated business income tax. Most states require that organizations register with the state attorney general's office or other agency prior to engaging in solicitation activities and that they submit annual information returns that document solicitation activities. Finally, donors and donees have certain obligations to each other and to the IRS with respect to disclosing information and substantiating donations.

## **ONGOING COMPLIANCE CONSIDERATIONS**

Charitable entities, no matter what their form, must comply with a variety of federal and state regulations. In addition, tribal law may specify other requirements. Again, to the extent applicable, compliance involves reporting and filing returns on an annual basis and making information available to the general public.

### **The Required Filing of Annual Federal Tax Information Returns**

With the exception of religious organizations, public charities with annual gross receipts that do not normally exceed \$25,000 and certain other exempt entities, private foundations and public charities must report on their organization and activities annually.<sup>245</sup> Public charities satisfy this requirement by filing IRS Form 990; private foundations file Form 990-PF. The IRS uses information from these returns to determine whether the organization continues to conform to the requirements for tax-exempt status.

### **Exception for Tribal Governments and Affiliated Organizations**

Under certain circumstances, a Section 501(c)(3) organization that is "an affiliate" of a tribal government or a tribal political subdivision is not required to file Form 990.<sup>246</sup> To be eligible for this exemption from filing, the tribal government entity must first be recognized as such by the IRS. In addition, an organization must meet the affiliation requirements spelled out in Revenue Procedure 95-48 and receive explicit permission from the IRS not to file as part of its initial determination letter or in a subsequent private letter ruling. Among the factors considered in determining affiliation status are control or oversight by, as well as financial accountability to, the tribal government or tribal political subdivision. Organizations that solicit charitable contributions from the public or grants from foundations may find that, although not legally required, filing a Form 990 is helpful in maintaining donor relations.

<sup>245</sup> IRC § 6033(a)(2)(A); IRS Announcement 82-88, 1982-25 I.R.B. 23. For a more detailed discussion of annual information returns, requirements, and exemptions, see Steven D. Simpson, *Tax-Exempt Organizations: Organization, Operation and Reporting Requirements* (1995).

<sup>246</sup> Rev. Proc. 95-48, 1995-2 C.B. 418. Even if an organization is not required to file Form 990, it must file Form 990-T, the Exempt Organization Business Income Tax Return, if it has more than \$1,000 in unrelated business income for the year. *Id.* at § 3.03.

### *Items Subject to Reporting*

To complete Forms 990 and 990-PF, organizations must provide: annual gross income, expenses, a balance sheet, disbursements for exempt purposes and total contributions and gifts received, including the names and addresses of substantial contributors. The organization must also provide the names and addresses of officers, directors and highly compensated employees and list the compensation each received.<sup>247</sup>

Private foundations, which file Form 990-PF rather than Form 990, must provide an itemized statement of securities and all other assets, an itemized statement of all grants made or approved for future payment—including the names and addresses of grantees and the purposes and amount of the grants—as well as the address of the foundation's principal office and the place where the foundation keeps its books and records.

Information provided on Form 990 and Form 990-PF enables the IRS to analyze whether the tax-exempt organization is conducting revenue-producing activities motivated by profits. To establish that profit is not a motivation, every item of revenue must be identified with an indication of whether, and if so how, it is related to the organization's tax-exempt purpose. Other data that must be reported on the form include:

- information on the organization's taxable subsidiaries,
- changes in the organization's governing documents,
- ownership interests in partnerships,
- changes in the size of the organization as a result of liquidations,
- receipts of nondeductible gifts, and
- requests by the public to see the organization's records (annual returns and application for recognition of tax exemption).

Section 501(c)(3) organizations are also required to provide information on direct and indirect transactions

or relationships with non-Section 501(c)(3) organizations—for example, lobbying groups or political action committees (PACs).<sup>248</sup> In reviewing this information, the IRS looks for any diversion of funds away from the charitable organization's exempt purpose or misallocation of revenues or expenses between organizations.

### *Penalties and Deadlines for Failure to File or Late Filing*

IRC Section 6072(e) sets the filing deadlines for returns. Unless an extension is obtained, Form 990 and Form 990-PF must be filed within four and one-half months after the close of the organization's fiscal year. Penalties are imposed for failing to provide for public inspection of annual information returns or applications for exemption.<sup>249</sup>

A failure to file the requisite form, or to include or correctly report required information results in a penalty of \$20 per day until the failure is reconciled. The maximum penalty assessable with respect to any one return is the lesser of \$10,000, or 5 percent of the organization's gross receipts for the year. An organization with gross receipts of more than \$1 million is subject to a fine of \$100 per day with a maximum penalty of \$50,000. In addition, any officer, director, trustee or other individual whose duty it is to file the return for the organization is liable for a \$10 per day penalty, with a maximum penalty of \$5,000.<sup>250</sup>

### **Public Inspection of Exemption Application and Form 990**

Every public charity must make its three most recent Form 990 returns and its Form 1023 application available for public inspection at its principal office and at any regional or district office with three or more employees.<sup>251</sup> In addition, legislation passed in 1996 will soon require that public charities provide "take home" copies of those forms to anyone who makes a request either in person or by mail. This requirement will take effect 60 days after the issuance of final

<sup>247</sup> Private foundations, but not public charities, must make the names of their substantial contributors available for public inspection and disclosure.

<sup>248</sup> IRC § 6033(b)(9).

<sup>249</sup> IRC § 6652(c)(1)(A).

<sup>250</sup> IRC § 6652(c)(1)(B).

<sup>251</sup> IRC § 6104(e)(1)(A).

Treasury regulations that interpret the new legislation.<sup>252</sup> A private foundation must also publish notice of availability of its latest Form 990-PF in a newspaper that has general circulation in the county in which the foundation's principal office is located.<sup>253</sup> The private foundation is then required to make the form available for public inspection on request for 180 days after the date it publishes notice of the form's availability.

Private foundations and public charities must also make their Form 1023, supporting documentation and any letter or other document issued by the IRS with respect to such application available to the public.<sup>254</sup> Public charities may, however, withhold information regarding the identity of their contributors.

The penalty for failing to make Form 1023 or requisite annual returns available for inspection is \$10 per day for each form: Only the penalty for failure to disclose annual returns is capped at \$5,000; the fine for failing to disclose is levied each day during which such failure continues.<sup>255</sup>

### *Unrelated Business Income Tax*

Even after the IRS has recognized the tax-exempt status of an organization, it may still be subject to a tax on any unrelated business income. Although generating unrelated business income does not usually jeopardize an organization's tax-exempt status, the income so generated is taxable at regular corporate tax rates.

Furthermore, an organization that engages in a substantial amount of activity in one or more unrelated trades or businesses may fail to meet the operational test and risk losing its tax-exempt status.

**General rules.** IRC Section 511 imposes a tax on the unrelated business income of Section 401(a) and

Section 501(c) organizations, as well as charitable trusts, state and tribal colleges and universities and certain Section 501(c)(2) organizations.<sup>256</sup> The unrelated business income tax (UBIT) is designed to decrease unfair competition by treating nonprofit organizations engaged in unrelated trades or businesses like their for-profit counterparts.

Activities that frequently produce unrelated business taxable income include:

- providing commercial-type insurance,
- leasing facilities to commercial entities,
- sale of advertising in publications,
- sale of goods or services that do not contribute importantly to the accomplishment of the organization's exempt purposes—for instance, certain gift shop sales, and
- raising funds through gambling operations (other than bingo).

Income from activities that involve the "exploitation of an exempt activity" also generate taxable income.<sup>257</sup> Although an organization must avoid having such activities become its primary purpose, it need not eliminate any and all activities that generate UBIT liability.

**Exceptions to UBIT.** Unrelated business taxable income derives from an unrelated trade or business *regularly carried on* by an organization, less certain modifications and deductions.<sup>258</sup> An unrelated trade or business is one that is not substantially related to the organization's exempt purpose.<sup>259</sup> Note, however, that certain activities are expressly excluded from the definition of unrelated trade or business, including:

- A trade or business where substantially all of the work is performed by volunteers;

<sup>252</sup> Taxpayer Bill of Rights 2, § 1313(a), amending 26 U.S.C. § 6104(c)(2). The IRS has issued proposed regulations and a Notice of Public Hearing on the Public Disclosure of Tax-Exempt Organizations' Tax Forms. 62 *Fed. Reg.* 50533 (Sept. 26, 1997). The public hearing was held on February 4, 1998. The regulations will not likely be finalized until later in 1998.

<sup>253</sup> IRC § 6104(d).

<sup>254</sup> Charities formed prior to, and that did not possess a copy of their applications for exemption as of July 1987 are exempt from this rule.

<sup>255</sup> IRC § 6652(c)(1)(C)-(D).

<sup>256</sup> Note that under IRC § 7871(a)(5), a tribal college or university is treated as a state college for purposes of the tax on unrelated business income.

<sup>257</sup> Treas. Reg. § 1.512(a)-1(f)(1).

<sup>258</sup> IRC § 512(a)(1).

<sup>259</sup> IRC § 513(a). An organization must also include within its unrelated business income a percentage of any income generated by debt-financed investment assets (IRC § 514 (a) and (b)).

- A business conducted primarily for the convenience of the members of a Section 501(c)(3) organization or a college or university, or that involves the sale of merchandise acquired by the organization through donations;<sup>260</sup>
- Certain other specific activities;<sup>261</sup> and
- Certain types of investment income.<sup>262</sup>

Royalties and rental income from real and personal property may also be excluded, subject to certain limitations.<sup>263</sup>

**Filing UBIT tax returns.** Any 501(c)(3) organization that has \$1,000 or more in unrelated business income for the year must file Form 990-T, the Exempt Organization Business Income Tax Return,<sup>264</sup> on or before the 15th day of the 5th month following the close of the tax year,<sup>265</sup>—May 15 for calendar-year taxpayers. As of January 1, 1997, the form must be filed with the IRS Center in Ogden, Utah.<sup>266</sup> Failure to comply with these requirements may result in tax liability. The regulations indicate that, “[o]rganizations subject to the tax imposed by Section 511(a)(1) are subject to the same provisions, including penalties, as are provided in the case of the income tax of other corporations.”<sup>267</sup>

Organizations with UBIT liability must make estimated tax payments in quarterly installments. This requirement is enforced by an additional tax on corporations that are taxable under IRC Section 11, but fail to make estimated payments.<sup>268</sup> Thus, a Section 501(c)(3) corporation must pay its estimated UBIT liability for the current tax year in quarterly installments

prior to the end of the current tax year, for example, tax liability for 1998 is estimated in 1998 and paid in quarterly payments on April 15, 1998, June 15, 1998, September 15, 1998, and December 15, 1998.

Estimated tax liability is computed on Form 990-W.

If an organization fails to file a timely return, pays its tax late or fails to make estimated tax payments, it may be subject to penalties and liable for interest on the unpaid or late payment of tax liability.<sup>269</sup>

## FEDERAL CHARITABLE FUNDRAISING DISCLOSURE AND SUBSTANTIATION

### Charitable Substantiation Rules

To obtain a charitable deduction, a donor making a contribution of \$250 or more must obtain from the charity a contemporaneous written acknowledgment of the donation.<sup>270</sup> Under the IRC, this acknowledgment is considered contemporaneous if the donor receives it on or before the earlier of the following: the date on which the donor files a tax return for the year in which the contribution was made or the due date, including extensions, for filing such return.<sup>271</sup> The acknowledgment must contain:

- the amount of cash and a description (but not necessarily the value) of any property other than cash contributed,
- disclosure of whether the donee organization provided any goods or services in consideration, in whole or in part, for the contribution, and

<sup>260</sup> IRC § 513 (a)(1), (2) and (3).

<sup>261</sup> Qualified public entertainment activities, qualified convention and trade show activities, certain hospital services, bingo games, pole rentals and the distribution of low-cost articles are all excluded from the definition of unrelated trade or business. See IRC § 513(d), (e), (f), (g) and (h).

<sup>262</sup> IRC § 512(b)(1).

<sup>263</sup> IRC § 512(b)(2) and (3).

<sup>264</sup> Treas. Reg. § 1.6012-2(e).

<sup>265</sup> IRC § 6072(e).

<sup>266</sup> IRS Announcement 96-63, 1996-29 I.R.B. 18.

<sup>267</sup> Treas. Reg. § 1.511-3(a).

<sup>268</sup> IRC § 6655. Under § 6655(g)(3), organizations subject to the UBIT tax and private foundations are treated as corporations taxable under § 11.

<sup>269</sup> IRC §§ 6665(a), 6651 and 6601.

<sup>270</sup> IRC § 170(f)(8)(A).

<sup>271</sup> IRC § 170(f)(8)(C).

- a description and good faith estimate of the value of any goods or services provided in consideration for the donation, including a statement of whether intangible religious benefits were provided to the donor.<sup>272</sup>

### **Quid Pro Quo Disclosure Rules**

If a donor makes a contribution of more than \$75 and receives goods or services in consideration for part of the contribution, the recipient organization must provide a written statement that:

- informs the donor that the amount of the contribution is deductible for federal income tax purposes only to the extent it exceeds the value of the goods or services provided by the organization, and
- provides the donor with a good faith estimate of the value of those goods or services.<sup>273</sup>

The penalty for failing to provide quid pro quo substantiation is \$10 per contribution, with a limit of \$5,000 with respect to a particular fundraising event or mailing.<sup>274</sup>

### **Disclosure of Federal Government Availability**

Charities that offer to sell or solicit money for specific information or a routine service that could readily be obtained from the federal government for free or for a nominal charge must make an express, conspicuous disclosure, when making the offer or solicitation, that the information or service can be so obtained.<sup>275</sup>

### **EMPLOYEE-RELATED FILINGS**

Section 501(c)(3) organizations are required to withhold and report income taxes and Social Security (FICA) taxes for their employees. They must file Form

941, the Employer's Quarterly Federal Tax Return, on a quarterly basis. They must also deposit income and FICA taxes at least quarterly, along with Form 8109, the Federal Tax Deposit Coupon. Taxes and Form 8109 must be deposited with an authorized commercial bank or a federal reserve bank.<sup>276</sup> Employers must also file a Form W-2, Wage and Tax Statement, annually for each employee.

Section 501(c)(3) organizations must also make a federal IRS filing when an independent contractor is paid more than \$600 in one year. IRC Section 6041(a) requires that payments to nonemployees in excess of \$600 be reported on Form 1099-MISC.

Section 501(c)(3) organizations are, however, exempt from paying federal unemployment taxes.<sup>277</sup> States and their political subdivisions are also exempt from paying federal unemployment taxes.<sup>278</sup> Note, however, that the IRS does not treat Indian tribes and their political subdivisions as states for unemployment tax purposes.

### **STATE-LEVEL FILINGS**

In addition to the federal filing requirements, Section 501(c)(3) organizations chartered under state law are usually required to make filings under state law. These filings include: the organization's application for exemption from state (and local) income, property and sales tax; annual state corporate filings; annual state tax information returns; and charitable solicitation registration returns. In addition, any organization that solicits charitable contributions in the state may be subject to certain state law filing requirements.

### **Application for Exemptions**

To obtain recognition of its exemption from various state taxes, the organization may have to make a sepa-

<sup>272</sup> IRC § 170(f)(8)(B).

<sup>273</sup> IRC § 6115(a)(1)-(2).

<sup>274</sup> IRC § 6714.

<sup>275</sup> IRC § 6711(a)(1) & (2).

<sup>276</sup> Treas. Reg. § 31.6011(a).

<sup>277</sup> IRC § 3306(c)(8).

<sup>278</sup> IRC § 3306(c)(7).

rate state law filing. The determination of whether to grant this status is made under state law. This issue requires legal analysis of the appropriate state's laws. Note, for example, that the grounds for exemption from a particular state or local tax can be substantially narrower than those for federal income taxes.

### State Tax Information Returns

Tax-exempt organizations formed under state corporate law are usually required to file annual state tax information returns—similar to the returns required under federal law—in the state (or states) in which they are located. For example, some states require that corporations file income tax returns or annual reports even if they are exempt from state taxes,<sup>279</sup> and some states impose unrelated business income taxes.<sup>280</sup> In some cases, a copy of the organization's Form 990 or 990-PF will satisfy state tax filing requirements. A charity incorporated under tribal law also might be required to register under or conform to state laws governing transactions by out-of-state corporations.

### Charitable Solicitation Filings

Most states and some localities require that charities register with the appropriate authority if they are going to engage in fundraising. Nonprofit organizations subject to these laws should be aware of such requirements if they seek donations in states that have enacted these laws. State laws on charitable solicitation are designed to protect citizens from unscrupulous solicitation practices.

Most states with charitable solicitation laws regulate this activity by requiring that organizations register with or obtain a license from the state before engaging

in fundraising activities within its borders.<sup>281</sup> Obtaining such permission typically involves filing an application with the state that provides information such as the name and address of the organization, its purpose, the methods that it will use to make solicitations, the purpose for which the organization will use donations, financial statements for the organization and the organization's tax status under federal law.<sup>282</sup>

The activities of certain types of people involved in the solicitation process—for instance, independent firms hired by the nonprofit organization to carry on its fundraising activities and persons sometimes termed “professional fundraisers”—may also be regulated under state laws, and separate registration requirements may apply to such persons.<sup>283</sup> For example, under the laws of the District of Columbia, a person soliciting donations must have a valid certificate of registration authorizing such activities.<sup>284</sup> In addition, a solicitor must have a solicitor information card.<sup>285</sup> The solicitor must provide the information on the card to persons from whom he or she attempts to solicit donations.

In addition to initial registration, many states require that any organization that solicits charitable contributions within the state file annual information returns.<sup>286</sup> These returns are distinct from annual tax or corporate informational returns; they specifically address the organization's charitable solicitation activities. A state may require that the organization provide information such as the amount of contributions that the organization collected in all jurisdictions, the amount used for or devoted to charitable purposes versus the amount paid for administration of the fundraising program and the net amount used in or devoted to the state.<sup>287</sup>

<sup>279</sup> See, D.C. Code Ann. § 47-1805.2(5) (1997); Mont. Code Ann. § 35-2-904 (1997).

<sup>280</sup> D.C. Code Ann. § 47.1802-1 (1997).

<sup>281</sup> See, D.C. Code Ann. § 2-703 (1994); N.D. Cent. Code § 50-22-02 (1982); N.Y. Executive Law § 172 (Consol. 1995).

<sup>282</sup> The Law of Fundraising (1996) § 4.2.

<sup>283</sup> Id. at §§ 4.5-4.6.

<sup>284</sup> D.C. Code Ann. § 2-703 (1994).

<sup>285</sup> D.C. Code Ann. § 2-705.

<sup>286</sup> D.C. Code Ann. § 47.1805.2(5); N.D. Cent. Code § 50-22-04 (1982).

<sup>287</sup> The Law of Fundraising at § 4.3.

## TRIBAL-LEVEL FILINGS

An Indian tribe that has based its nonprofit or general corporations law on state or model statutes is likely to require that a charity incorporated under tribal law fulfill similar responsibilities, such as:

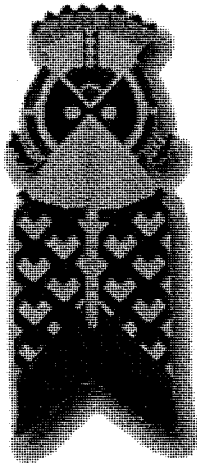
- filing an annual information return,
- providing current information as to its registered agent, and
- registering under a charitable solicitations statute.

A tribal charity organized under state law should also determine whether any additional filings are required to operate within the tribal jurisdiction. As with states, an Indian tribe may have its own criteria with respect to obtaining and maintaining tax-exempt status. Thus, an examination of tribal law requirements is essential in each instance.

## CONCLUSION: OPTIONS AND OPPORTUNITIES

This legal manual offers an abundance of information on options and opportunities for American Indian tribes and Native American communities to develop their formalized charitable giving and fundraising activities. The manual reflects current law and regulations, but these are fluid, not fixed—and are subject to change throughout time. The current framework of laws provides a useful point of departure, however, as American Indian tribes and, indeed, any Native American community, can select and adapt those charitable mechanisms that are most suitable. Finally, persons using this manual may find ways to improve the current laws and regulations, and would be doing a public service to bring suggested changes to the attention of the appropriate tribal, local, state or federal government official or legislator.





## **APPENDIXES**

### **A. GLOSSARY**

### **B. BIOGRAPHIES OF THE AUTHORS**

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3. Revenue Procedure 84-37 (setting forth procedures for requesting recognition as an Indian tribal government under Section 7871)

## APPENDIXES

### A. GLOSSARY

**Adjusted gross income.** Gross income less certain deductions specified in the Internal Revenue Code (IRC).

**Community foundation.** A tax-exempt, nonprofit, autonomous, publicly supported philanthropic institution composed primarily of permanent funds endowed by many separate donors for the long-term benefit of the residents of a defined geographic area.

**Cost basis.** Basis determined by the property's cost, which then may be adjusted for depreciation, losses, capital charges and other items specified in the IRC.

**Expenditure responsibility.** A set of specific procedures that a private foundation must exercise when making a grant to an organization that has not been classified as a public charity by the Internal Revenue Service (IRS).

**Federally chartered tribal corporation.** An Indian tribal corporation, formed under Section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. § 477, or Section 3 of the Oklahoma Indian Welfare Act, 25 U.S.C. § 503.

**Federally recognized tribe.** A tribe recognized as an Indian tribe by the Department of the Interior.

**Gross income.** Under Section 61(a) of the IRC, "all income from whatever source derived," except for certain exclusions from gross income specified in the IRC.

**Gross receipts charitable organizations.** Public charities that normally receive more than one-third of their support from gifts, grants, fees and gross receipts from conducting exempt activities but do not normally receive more than one-third of their support from investment income.

**Indian tribal government.** Under Section 7701(a)(40) of the IRC, the governing body of any Indian tribe, band, community, village or group of Indians or (if applicable) Alaska Natives, which is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions.

**Intermediate sanctions.** Under IRC Section 4958, penalties imposed when a public charity or social welfare organization directly or indirectly provides certain "disqualified persons" (or "insiders") an economic benefit that exceeds the value of the consideration received for providing such benefit.

**Internal Revenue Code (IRC).** Unless otherwise specified, the Internal Revenue Code of 1986, as amended.

**Operating foundation.** A private foundation that spends substantially all of its net investment income directly for the active conduct of its exempt activities. Although an operating foundation must follow most of the private foundation rules, donors can deduct their contributions to an operating foundation subject to the same percentage-of-income limitations applicable to public charity donors.

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**Private foundation.** Generally, an organization that has a limited number of funding sources (usually one individual, family or corporation), engages in grantmaking activities rather than direct charitable activities, and derives funds for ongoing expenses and grants from endowment income. Under IRC Section 509(a)(1), the term "private foundation" refers to a Section 501(c)(3) charitable organization other than "public charities" and organizations operated exclusively for testing for public safety.

**Private inurement.** The transfer of a tax-exempt organization's financial resources to an insider, such as an officer, director or contributor, without regard to accomplishing exempt purposes.

**Private letter ruling.** A ruling issued by the IRS at the request of a specific individual or organization. Although a private letter ruling may be revoked and may not be cited as precedent by other taxpayers, it may provide helpful guidance as to how the IRS is likely to interpret the law under similar facts and circumstances to those described in the ruling.

**Public charity.** Generally, a Section 501(c)(3) charitable organization that receives a substantial amount of its support from public or government sources, from conducting exempt activities or from supporting other organizations that are either public charities or similar to public charities.

**Public support.** Generally, support received from public or governmental sources and, with respect to "gross receipts charitable organizations," membership fees and gross receipts from conducting exempt activities.

**Publicly supported (or traditional) charitable organizations.** Under IRC Sections 170(b)(1)(A) and 509(a)(1), a class of public charities that includes churches, schools, hospitals, support organizations to schools, certain governmental units (not including Indian tribal governments) and charities that meet criteria demonstrating a sufficient level of public support through contributions from public or governmental sources or through other forms of community involvement.

**Qualifying distribution.** An expenditure for charitable purposes by a private foundation that qualifies for purposes of the minimum distribution requirements of IRC Section 4942. Generally, this includes grants to qualified charities and reasonable costs of grantmaking and conducting direct charitable activities.

**Social welfare organization.** An organization that qualifies for tax exemption under IRC Section 501(c)(4). In contrast to the activities of a Section 501(c)(3) charitable organization, a substantial part of the activities of a social welfare organization can include political or lobbying activities. Contributions to 501(c)(4) organizations are not eligible for income, gift or estate tax charitable deductions.

**Supporting organizations.** Organizations controlled by and closely associated with one or more public charities.

**Treasury regulations.** Regulations issued by the Secretary of the Treasury and administered by the IRS under authority granted by Congress in the IRC.

**Trust land.** Refers to land that has been taken into trust on behalf of an Indian tribe by the Federal Government; such trust land may be within or outside of a formal reservation.

## APPENDIXES

# B. BIOGRAPHIES OF THE AUTHORS

**Kathleen M. Nilles** is a partner in the law firm of Gardner, Carton & Douglas. Her practice areas include federal tax issues, tax-exempt organizations, federal Indian law and health care tax law. In her practice, Ms. Nilles routinely prepares submissions to the Internal Revenue Service and the Treasury Department on behalf of American Indian tribes, as well as opinions of counsel and memoranda on federal tax and employee benefits issues. Previously, she served as tax counsel to the Ways and Means Committee, U.S. House of Representatives. Ms. Nilles earned her L.L.M. in tax from Georgetown University, her J.D. from the University of Virginia and an M.A. from Yale Divinity School.

**Douglas B.L. Endreson** is a specialist in Indian rights litigation with the firm of Sonosky, Chambers, Sachse & Endreson. He joined the Sonosky firm in 1983 and became a partner in 1985. Prior to this position, Mr. Endreson clerked for the Honorable Shirley S. Abrahamson, who is now Chief Justice of the Wisconsin Supreme Court; was a staff attorney at the Native American Rights Fund; and served as a Visiting Professor of Law at the Arizona State University College of Law and the University of New Mexico Law School. He received his J.D., with honors, and his L.L.M. from the University of Wisconsin Law School.

**Amy Locklear** is an associate with the law firm of Sonosky, Chambers, Sachse & Endreson, which specializes in Indian law. Her areas of practice include Indian and tax law. Ms. Locklear received her L.L.M. in taxation from Georgetown Law Center in 1998, and her J.D. from the University of Arizona College of Law. She is a member of the Lumbee Tribe.

**Jeffrey A. Trexler** is an assistant professor of law at St. Louis University School of Law, specializing in tax and tax-exempt organizations. Previously, he was an associate in the Chicago Office of Gardner, Carton & Douglas and was a law clerk for the Honorable Dorothy W. Nelson, U.S. Circuit Judge, Ninth Circuit Court of Appeals. Mr. Trexler received his J.D. from Yale University Law School and earned a Ph.D. from Duke University.

## C. SELECTED INTERNAL REVENUE CODE PROVISIONS

### SECTION 7871. INDIAN TRIBAL GOVERNMENTS TREATED AS STATES FOR CERTAIN PURPOSES.

- (a) General rule. An Indian tribal government shall be treated as a State—
  - (1) for purposes of determining whether and in what amount any contribution or transfer to or for the use of such government (or a political subdivision thereof) is deductible under—
    - (A) section 170 (relating to income tax deduction for charitable, etc., contributions and gifts),
    - (B) sections 2055 and 2106(a)(2) (relating to estate tax deduction for transfers of public, charitable, and religious uses), or
    - (C) section 2522 (relating to gift tax deduction for charitable and similar gifts);
  - (2) subject to subsection (b), for purposes of any exemption from, credit or refund of, or payment with respect to, an excise tax imposed by—
    - (A) chapter 31 (relating to tax on special fuels),
    - (B) chapter 32 (relating to manufacturers excise taxes),
    - (C) subchapter B of chapter 33 (relating to communications excise tax), or
    - (D) subchapter D of chapter 36 (relating to tax on use of certain highway vehicles);
  - (3) for purposes of section 164 (relating to deduction for taxes);
  - (4) subject to subsection (c), for purposes of section 103 (relating to State and local bonds);
  - (5) for purposes of section 511(a)(2)(B) (relating to the taxation of colleges and universities which are agencies or instrumentalities of governments or their political subdivisions);
  - (6) for purposes of—
    - (A) section 105(e) (relating to accident and health plans),
    - (B) section 403(b)(1)(A)(ii) (relating to the taxation of contributions of certain employers for employee annuities), and
    - (C) section 454(b)(2) (relating to discount obligations); and
    - (D) [Redesignated]
  - (7) for purposes of—
    - (A) chapter 41 (relating to tax on excess expenditures to influence legislation), and
    - (B) subchapter A of chapter 42 (relating to private foundations).
- (b) Additional requirements for excise tax exemptions. Paragraph (2) of subsection (a) shall apply with respect to any transaction only if, in addition to any other requirement of this title applicable to similar transactions involving a State or political subdivision thereof, the transaction involves the exercise of an essential governmental function of the Indian tribal government.
- (c) Additional requirements for tax-exempt bonds.

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- (1) In general. Subsection (a) of section 103 shall apply to any obligation (not described in paragraph (2)) issued by an Indian tribal government (or subdivision thereof) only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function.
- (2) No exemption for private activity bonds. Except as provided in paragraph (3), subsection (a) of section 103 shall not apply to any private activity bond (as defined in section 141(a)) issued by an Indian tribal government (or subdivision thereof).
- (3) Exception for certain private activity bonds.
- (A) In general. In the case of an obligation to which this paragraph applies—
- (i) paragraph (2) shall not apply,
  - (ii) such obligation shall be treated for purposes of this title as a qualified small issue bond, and
  - (iii) section 146 shall not apply.
- (B) Obligations to which paragraph applies. This paragraph shall apply to any obligation issued as part of an issue if—
- (i) 95 percent or more of the net proceeds of the issue are to be used for the acquisition, construction, reconstruction, or improvement of property which is of a character subject to the allowance for depreciation and which is part of a manufacturing facility (as defined in section 144(a)(12)(C)),
  - (ii) such issue is issued by an Indian tribal government or a subdivision thereof,
  - (iii) 95 percent or more of the net proceeds of the issue are to be used to finance property which—
    - (I) is to be located on land which, throughout the 5-year period ending on the date of issuance of such issue, is part of the qualified Indian lands of the issuer, and
    - (II) is to be owned and operated by such issuer,
  - (iv) such obligation would not be a private activity bond without regard to subparagraph (C),
  - (v) it is reasonably expected (at the time of issuance of the issue) that the employment requirement of subparagraph (D)(i) will be met with respect to the facility to be financed by the net proceeds of the issue, and
  - (vi) no principal user of such facility will be a person (or group of persons) described in section 144(a)(6)(B).
- For purposes of clause (iii), section 150(a)(5) shall apply.
- (C) Private activity bond rules to apply. An obligation to which this paragraph applies (other than an obligation described in paragraph (1)) shall be treated for purposes of this title as a private activity bond.
- (D) Employment requirements.
- (i) In general. The employment requirements of this subparagraph are met with respect to a facility financed by the net proceeds of an issue if, as of the close of each calendar year in the testing period, the aggregate face amount of all outstanding tax-exempt private activity bonds issued to provide financing for the establishment which includes such facility is not more than 20 times greater than the aggregate wages (as defined by section 3121(a)) paid during the preceding calendar year to individuals (who are enrolled members of the Indian tribe of the issuer or the spouse of any such member) for services rendered at such establishment.
  - (ii) Failure to meet requirements.
    - (I) In general. If, as of the close of any calendar year in the testing period, the requirements of this subparagraph are not met with respect to an establishment, section 103 shall cease to apply to

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- interest received or accrued (on all private activity bonds issued to provide financing for the establishment) after the close of such calendar year.
- (II) Exception. Subclause (I) shall not apply if the requirements of this subparagraph would be met if the aggregate face amount of all tax-exempt private activity bonds issued to provide financing for the establishment and outstanding at the close of the 90th day after the close of the calendar year were substituted in clause (i) for such bonds outstanding at the close of such calendar year.
- (iii) Testing period. For purposes of this subparagraph, the term "testing period" means, with respect to an issue, each calendar year which begins more than 2 years after the date of issuance of the issue (or, in the case of a refunding obligation, the date of issuance of the original issue).
- (E) Definitions. For purposes of this paragraph—
- (i) Qualified Indian lands. The term "qualified Indian lands" means land which is held in trust by the United States for the benefit of an Indian tribe.
- (ii) Indian tribe. The term "Indian tribe" means any Indian tribe, band, nation, or other organized group or community which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.
- (iii) Net proceeds. The term "net proceeds" has the meaning given such term by section 150(a)(3).
- (d) Treatment of subdivisions of Indian tribal governments as political subdivisions. For the purposes specified in subsection (a), a subdivision of an Indian tribal government shall be treated as a political subdivision of a State if (and only if) the Secretary determines (after consultation with the Secretary of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.
- (e) Essential governmental function. For purposes of this section, the term "essential governmental function" shall not include any function which is not customarily performed by State and local governments with general taxing powers.

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## SECTION 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

- (1) Person. The term “Person” shall be construed to mean and include an individual, a trust, estate, partnership, association, company, or corporation.
- (2) Partnership and partner. The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term “partner” includes a member in such a syndicate, group, pool, joint venture, or organization.
- (3) Corporation. The term “corporation” includes associations, joint-stock companies, and insurance companies.
- (4) Domestic. The term “domestic” when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations.

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(40) Indian tribal government.

- (A) In general. The term “Indian tribal government” means the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary, after consultation with the Secretary of the Interior, to exercise governmental functions.
- (B) Special rule for Alaska natives. No determination under subparagraph (A) with respect to Alaska Natives shall grant or defer any status or powers other than those enumerated in section 7871. Nothing in the Indian Tribal Governmental Tax Status Act of 1982, or in the amendments made thereby, shall validate or invalidate any claim by Alaska Natives of sovereign authority over lands or people.



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## SAMPLE ARTICLES OF INCORPORATION FOR A CHARITABLE CORPORATION

*Note: The Articles of Incorporation that follow here are not a model to copy; rather, they are provided purely to illustrate what such a document might look like and include language to satisfy current federal tax law. Depending on whether the corporation is formed under State or tribal law, the Articles also must conform to State or tribal law requirements. Such requirements, however, will not override federal tax requirements.*

### ARTICLE I

The name of the corporation is the ABC Corporation ("Corporation").

### ARTICLE II

The name and address of the registered agent and the registered office are:

Registered Agent: John Doe

Registered Office: Indian Country, USA

### ARTICLE III

The Corporation is organized and shall be operated exclusively for charitable, scientific or educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (or the corresponding provision of any future United States Internal Revenue Law) (hereinafter, all references to "Section" or "Sections" refer to sections of the Internal Revenue Code of 1986, as amended to date). In furtherance of such purposes, the Corporation may:

- (a) ...
- (b) ...
- (c) ...
- (d) Otherwise operate exclusively for charitable, scientific or education purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, in the course of which operations:
  - (i) No part of the net earnings of the Corporation shall inure to the benefit of, or be distributable to, any private shareholder or individual, except that the Corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth herein.
  - (ii) No substantial part of the activities of the Corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the Corporation shall not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office, except as authorized under the Internal Revenue Code.
  - (iii) Notwithstanding any other provisions of these articles, the Corporation shall not carry on any other activities not permitted to be carried on (a) by a corporation exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code or (b) by a corporation, contributions to which are deductible under Section 170(c)(2).

### ARTICLE IV

Upon the dissolution of the Corporation, assets shall be distributed for one or more exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, or the corresponding Section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose. Any

such assets not so disposed of shall be disposed of by a Court of Competent Jurisdiction of the county in which the principal office of the Corporation is then located, exclusively for such purposes or to such organization or organizations, as said court shall determine, which are organized and operated exclusively for such purposes.

#### ARTICLE V

The Corporation shall be organized on a nonstock basis and shall have no members.

#### ARTICLE VI

The authority for all affairs of the Corporation shall be in a Board of Directors who shall have and may exercise all the powers of the Corporation as permitted by federal law and state [Tribal] law these Articles of Incorporation and the Bylaws of the Corporation as from time to time in effect. The first Board of Directors shall be \_\_\_\_ in number and their names and addresses being as follows:

NAME \_\_\_\_\_ ADDRESS \_\_\_\_\_

NAME \_\_\_\_\_ ADDRESS \_\_\_\_\_

NAME \_\_\_\_\_ ADDRESS \_\_\_\_\_

The undersigned incorporator(s) hereby declare(s), under penalty of perjury, that the statements made in the foregoing Articles of Incorporation are true.

SIGNATURE \_\_\_\_\_ DATE \_\_\_\_\_

NAME \_\_\_\_\_ STREET \_\_\_\_\_

CITY/TOWN \_\_\_\_\_ STATE/ZIP \_\_\_\_\_

## APPENDIXES

# D. SAMPLE DOCUMENTS

### SAMPLE TRIBAL COUNCIL RESOLUTION CREATING A RESTRICTED FUND FOR CHARITABLE PURPOSES

Resolution No. \_\_\_\_ \*

**WHEREAS**, the Tribal Council is the duly elected governing body of the Indian tribe, and is empowered to act on behalf of the Indian tribe; and

**WHEREAS**, the Indian tribe seeks to fund charitable programs and activities that contribute to the well-being of the Tribal community and Indian people in general; and

**WHEREAS**, the Indian tribe wishes to effectuate these goals by creating a Tribal Restricted Fund from which the Indian tribe shall make grants to worthy charitable organizations and projects for said purposes;

**NOW THEREFORE BE IT RESOLVED**, that the Tribal Council establishes the Tribal Restricted Fund Board, who shall serve as the governing body of the Tribal Restricted Fund; and

**BE IT FURTHER RESOLVED**, the Tribal Council shall provide in bylaws, the rules governing the selection of the members of the Tribal Restricted Fund Board and the terms of their service on the Board; and

**[OPTIONAL: BE IT FURTHER RESOLVED**, that on an annual basis, the Tribal Council shall fund the Tribal Restricted Fund . . . (the Tribal Council can designate a source for funding the Tribal Restricted here)]; and

**BE IT FURTHER RESOLVED**, for purposes of facilitating the award of grants to charitable organizations and activities, the Tribal Restricted Fund Board is authorized to establish grantmaking procedures [subject to the approval of the Tribal Council]; and

**BE IT ALSO RESOLVED**, the Tribal Restricted Fund Board is authorized to employ necessary personnel to administer the Tribal Restricted Fund in accordance with the established grantmaking procedures.

#### [CERTIFICATION]

*\* Note: This sample resolution creates a restricted fund from which grants are made to charitable organizations or for charitable activities. The tribal government or a tribal enterprise provides the resources for this fund. If a tribal restricted fund maintained by a federally-recognized Indian tribal government also receives individual donations from the general public and such donations are used for exclusively public purposes, individual donors should be eligible for a charitable contribution deduction under IRC Sections 170 and 7871.*

## **SAMPLE TRIBAL LAW RESTRICTING THE USE OF CHARITABLE TRIBAL CONTRIBUTIONS FOR CHARITABLE AND EDUCATIONAL PURPOSES**

Law No. \_\_\_\_ \*

### **SEC. 101. USE OF CHARITABLE CONTRIBUTIONS BY TRIBAL GOVERNMENT: CHARITABLE AND EDUCATIONAL PURPOSES**

#### **(a) Use of Donation**

Donations of money or property to the Tribal Government (including any agency, branch or division of the Tribal Government) shall be used for exclusively public purposes, including, but not limited to, charitable and educational purposes.

#### **(b) Use of Donations Not Earmarked by Donors**

Donations not earmarked for use by a designated entity or program within the Tribal Government may be designated for use by the Tribal Council, provided such designation is for exclusively public purposes. The Tribal Council may also transfer such donations for use by an agency, branch or division of the Tribal Government, subject to the limitations in (a).

#### **(c) Charitable Substantiation**

If a donor contributes money or property valued at \$250 or more to the Tribal Government, the entity receiving the donation (the donee (e.g., Tribal Council or Tribal agency, branch, or division of the Tribal Government)) must provide the donor with a written acknowledgment of the donation. The donee must provide the written acknowledgment to the donor by the date the donor files his or her federal tax return for the year of the contribution or the donor's due date for filing the return. The acknowledgment must describe the property or amount of money contributed, whether the donor received goods or services in whole or in part for the contribution, and an estimate of the value of goods or services (if any) provided in consideration of the donation.

#### **(d) Quid Pro Quo Disclosure**

If a donor contributes more than \$75 to the Tribal Government and the entity receiving the donation (the donee (e.g., Tribal Council or Tribal agency, branch or division of the Tribal Government)) provides the donor with goods or services in consideration for part of the contribution, the donee must provide the donor with a statement indicating that the donation is deductible only to the extent that the goods or services provided by the donee exceed the value of the donation. The statement must also provide a good faith estimate of the value of the goods or services.

*\* Note: This sample tribal law incorporates federal tax law requirements related to the tax deductibility of charitable contributions contained in IRC Sections 170 and 7871.*

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## SAMPLE ARTICLES OF INCORPORATION FOR A PRIVATE FOUNDATION

*Note: The Articles of Incorporation that follow here are not a model to copy; rather, they are provided purely to illustrate what such a document might look like and include language to satisfy current federal tax law. Depending on whether the Foundation is formed under State or tribal law, the Articles also must conform to State or tribal law. Such requirements, however, will not override federal tax requirements.*

### ARTICLE I

The name of the foundation is XYZ Foundation ("Foundation").

### ARTICLE II

The name and address of the registered agent and the registered office are:

Registered Agent: Jane Doe

Registered Office: Indian Country, USA

### ARTICLE III

The Foundation is organized and shall be operated exclusively for charitable, scientific or educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (or the corresponding provision of any future United States Internal Revenue Law) (hereinafter, all references to "Section" or "Sections" refer to sections of the Internal Revenue Code of 1986, as amended). In furtherance of such purposes, the Foundation may:

- (a) ...
- (b) ...
- (c) ...
- (d) Otherwise operate exclusively for charitable, scientific or education purposes within the meaning of Section 501(c)(3), in the course of which operations:
  - (i) No part of the net earnings of the Foundation shall inure to the benefit of, or be distributable to, any private shareholder or individual, except that the Foundation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth herein.
  - (ii) No substantial part of the activities of the Foundation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the Foundation shall not participated in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office, except as authorized under the Internal Revenue Code.
  - (iii) Notwithstanding any other provisions of these articles, the Foundation shall not carry on any other activities not permitted to be carried on (a) by a corporation exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code or (b) by a corporation, contributions to which are deductible under Section 170(c)(2).
  - (iv) The Foundation shall distribute its income for each tax year at such times and in such manner so as to not subject the Foundation to the tax on undistributed income under Section 4942 of the Internal Revenue Code. The Foundation shall not engage in any act of self-dealing as defined in Section 4941(d), shall not retain any excess business holdings as defined in Section 4943(c), nor make any investments so as to subject the Foundation to tax under Section 4944, nor make any taxable expenditures as defined in Section 4945(d).

#### ARTICLE IV

In the event of the dissolution of the Foundation, the board of directors shall, after paying or making provision for the payment of all of the liabilities of the Foundation, distribute all of the assets of the Foundation to XYZ Corporation, a [specify jurisdiction] not-for-profit corporation, if then in existence and if qualified under Section 501(c)(3) of the Internal Revenue Code, or to such organization or organizations organized and operated exclusively for charitable, educational or scientific purposes as shall at the time qualify as an exempt organization or organizations under Section 501(c)(3), as the board of directors shall determine. Any such assets not so disposed of shall be disposed of by a court of competent jurisdiction of the county in which the principal office of the Foundations is then located exclusively for such purposes or to such organization or organizations, as said court shall determine, which are organized and operated exclusively for such purposes.

#### ARTICLE V

The Foundation shall be organized on a nonstock basis and shall have no members.

#### ARTICLE VI

The authority for all affairs of the Foundation shall be in a Board of Directors who shall have and may exercise all the powers of the Foundation as permitted by federal law and state [Tribal] law these Articles of Incorporation and the Bylaws of the Foundation as from time to time in effect. The first Board of Directors shall be \_\_\_\_ in number and their names and addresses being as follows:

NAME \_\_\_\_\_ ADDRESS \_\_\_\_\_

NAME \_\_\_\_\_ ADDRESS \_\_\_\_\_

NAME \_\_\_\_\_ ADDRESS \_\_\_\_\_

The undersigned incorporator(s) hereby declare(s), under penalty of perjury, that the statements made in the foregoing Articles of Incorporation are true.

SIGNATURE \_\_\_\_\_ DATE \_\_\_\_\_

NAME \_\_\_\_\_ STREET \_\_\_\_\_

CITY/TOWN \_\_\_\_\_ STATE/ZIP \_\_\_\_\_

## APPENDIXES

# E. IRS RULINGS AND PROCEDURES

## REVENUE RULING 67-284

### 1967-2 C.B. 55; 1967 IRB LEXIS 12 (JULY, 1967)

*Principles applicable to the Federal income tax treatment of income paid to or on behalf of enrolled members of Indian tribes. Revenue Ruling 62-16, C.B. 1962-1, 7, modified. The Internal Revenue Service has been requested to set for the general principles applicable to the Federal income tax treatment of income paid to or on behalf of enrolled members of Indian tribes.*

#### I. Tax Status of Indians.

There is no provision in the Internal Revenue Code of 1954 which exempts an individual from the payment of Federal income tax solely on the ground that he is an Indian. Therefore, exemption of Indians from the payment of tax must derive plainly from treaties or agreements with the Indian tribes concerned, or some act of Congress dealing with their affairs. See Rev. Rul. 54-456, C.B. 1954-2, 49, and the cases cited therein.

Similarly, in considering the general tax status of Indians, the Supreme Court of the United States in its decision in *Squire v. Capoeman*, cited and discussed below, stated: "We agree with the Government that Indians are citizens and that in ordinary affairs of life, not governed by treaties or remedial legislation, they are subject to the payment of income taxes as are other citizens."

#### II. Basic Categories of Income.

Two basic categories of income are not subject to Federal income tax, to wit, where a treaty, agreement or act of Congress expressly provides that income is not subject to tax, and where income is derived directly from restricted allotted land held under circumstances discussed below.

The issue in *Squire v. Capoeman*, 351 U.S. 1 (1956), Ct. D. 1796, C.B. 1956-1, 605, was whether the gain from the sale of timber from restricted allotted lands, held in trust for a noncompetent Indian under the General Allotment Act of 1887, 24 Stat. 388, 25 U.S.C. 331 et seq., was subject to Federal income tax. The General Allotment Act had begun a new era in Federal Indian policy whereby tribal lands were to be divided and allotted to members of the tribe. The allotments were to be held in trust by the Government for 25 years or longer if the President deemed an extension desirable and then transferred to the allottee discharged of Government trusteeship "free of all charge or incumbrance whatsoever." The purpose of the act was to protect the Indians' interest and to prepare the Indians to take their place as independent qualified members of the modern body politic.

Section 6 of the act included a proviso authorizing the Secretary of the Interior to issue a patent in fee simple to any allottee competent of managing his own affairs, "and thereafter all restrictions as to sale, incumbrance, or taxation of said land shall be removed and said land shall not be liable to the satisfaction of any debt contracted prior to the issuing of such patent..." 25 U.S.C. 349. The court concluded that the literal language of the proviso evinces a

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congressional intent to subject an allotment to all taxes only after a patent in fee is issued, and implies that until the patent is issued, the allotment is to be free from all present and future taxes.

In holding that the income in question was not subject to Federal income tax, the court concluded that to deny exemption would thwart the congressional intent manifested in the Allotment Act of not subjecting to the burdens of taxation proceeds from the allotment until the Indian had been emancipated and had received his title in fee for the land.

It is thus the position of the IRS that income derived directly by a noncompetent Indian from allotted and restricted land held under the General Allotment Act or derived directly from land held under acts or treaties containing an exception provision similar to the General Allotment Act is not subject to the Federal income tax. See Rev. Rul. 59-349, C.B. 1959-2, 16, and Rev. Rul. 63-244, C.B. 1963-2, 21.

The IRS will therefore recognize the exempt status of income received by an enrolled member of an Indian tribe where each of the following tests are met: (1) the land in question is held in trust by the United States Government; (2) such land is restricted and allotted and is held for an individual noncompetent Indian, and not for a tribe; (3) the income is "derived directly" from the land; (4) the statute, treaty or other authority involved evinces congressional intent that the allotment be used as a means of protecting the Indian until such time as he becomes competent; and (5) the authority in question contains language indicating clear congressional intent that the land, until conveyed in fee simple to the allottee, is not to be subject to taxation. If one or more of these five tests is not met, and if the income is not otherwise exempt by law, it is subject to Federal income taxation.

### **III. Income—Restricted Allotted Land.**

Income held by the court in *Capoeman* to be exempt from tax was categorized as income "derived directly" from the allotted and restricted lands. In Revenue Ruling 56-342, C.B. 1956-2, 20, as amplified by Revenue Ruling 62-16, C.B. 1962-, 7, this holding was interpreted to mean that income exempt under the *Capoeman* decision includes: rentals (including crop rentals), royalties, proceeds from the sale of the natural resources of the land, income from the sale of crops grown upon the land and from the use of the land for grazing purposes, and income from the sale or exchange of cattle or other livestock raised on the land. Proceeds from the sale of restricted allotted land while the fee title is still held by the Government in trust for the Indian are also exempt from tax. Rev. Rul. 57-407, C.B. 1957-2, 45.

Income derived from reinvesting income which is exempt under the five tests set forth in section II above is not exempt. To be exempt, income must be directly derived or attributable to the use or exploitation of the allotted land. See *Superintendent of Five Civilized Tribes v. Commissioner*, 295 U.S. 418 (1935), Ct. D. 974, C.B. XIV-1, 158 (1935). Income from a trust allotment rented from another Indian is not exempt. Rev. Rul. 57-523, C.B. 1957-2, 51.

### **IV. Transfer of Restricted Allotted Land.**

Income exempt under the five tests set forth in section II above remains exempt when the allotment is transferred to another noncompetent Indian by gift, devise or inheritance, even though the transferee may be of mixed Indian blood. See Rev. Rul. 57-523 and Rev. Rul. 62-16. Nor does the exemption cease when restricted allotted land is voluntarily exchanged for restricted allotted land of like value, when such exchange is authorized by the Secretary of Interior.

In Revenue Ruling 62-16, it was held that unless otherwise provided by law, income from allotted land is not exempt where the Indian obtains his interest in the exempt land through an arm's length purchase. This position has



## REVENUE RULING 94-16

### 1994-1 C.B. 19; 1994 IRB LEXIS 151 (MARCH 21, 1994)

*Federal income taxation of Indian tribes and corporations organized by Indian tribes. Neither an unincorporated Indian tribe nor a corporation organized under Section 17 of the Indian Reorganization Act of 1934 is subject to federal income tax on its income, regardless of the location of the activities that produced the income. However, a corporation organized by an Indian tribe under state law is subject to federal income tax on its income, regardless of the location of the activities that produced the income. Rev. Rul. 81-295 clarified and Rev. Rul. 67-284 amplified.*

#### ISSUE

Is income earned by an Indian tribe or tribal corporation from the conduct of a commercial business subject to federal income tax?

#### FACTS

Situation 1. Tribe T, a federally recognized Indian tribe, conducts an unincorporated commercial business both on and off T's reservation.

Situation 2. Tribe U incorporates itself as Corporation X under Section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. section 477 (1993) (IRA). X conducts a commercial business both on and off U's reservation.

Situation 3. Tribe V organizes Corporation Y under the law of State S. V is the sole shareholder of Y, which conducts a commercial business both on and off V's reservation.

#### LAW AND ANALYSIS

Section 1 of the Internal Revenue Code imposes a tax on the taxable income of individuals, trusts and estates. Section 11 imposes a tax on the taxable income of corporations.

Section 61 of the IRC provides that gross income means all income from whatever source derived, unless otherwise provided by law. Section 63 defines taxable income as gross income minus deductions.

Revenue Ruling 67-284, 1967-2 C.B. 55, 58, modified on another issue by Rev. Rul. 74-13, 1974-1 C.B. 14, holds that Indian tribes are not taxable entities. The revenue ruling further holds that tribal income not otherwise exempt from federal income tax is includible in the gross income of the Indian tribal member when distributed to, or constructively received by, the tribal member.

Revenue Ruling 81-295, 1981-2 C.B. 15, relying on *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 157, n.13 (1973), holds that an Indian tribal corporation organized under Section 17 of the IRA shares the same tax status as the Indian tribe and is not taxable on income from activities carried on within the boundaries of the reservation.

However, a corporation organized by an Indian tribe under state law is not the same as an Indian tribal corporation organized under Section 17 of the IRA and does not share the same tax status as the Indian tribe for federal income tax purposes. Generally, the choice of corporate form will not be ignored. See *Moline Properties v. Commissioner*, 319 U.S. 436 (1943).

Because an Indian tribe is not a taxable entity, any income earned by an unincorporated tribe, regardless of the location of the business activities that produced the income, is not subject to federal income tax. An Indian tribal corporation organized under Section 17 of the IRA shares the same tax status as the tribe. Therefore, any income earned by such a corporation, regardless of the location of the business activities that produced the income, is not

been reconsidered in view of transactions by Indians regarded as unable to handle their own affairs to make intrafamily transfers of allotments or to assist needy Indians in acquiring small amounts of land where the purchase money consisted of restricted funds. The Service now concludes that income will ordinarily retain its exempt status when restricted allotted land is acquired for the above purposes by Deed Form 5-183b, unless the facts and circumstances clearly show the transfers were not made for such purposes. Revenue Ruling 62-16, C.B. 1962-1, 7, is modified to the extent inconsistent herewith.

Once an Indian has received a fee title to the land, the exempt status of income derived directly therefrom ends. See Rev. Rul. 58-341, C.B. 1958-2, 400, which discusses basis problems where the land is sold subsequent to being conveyed in fee simple to an Indian.

## **V. Status of Tribes; Tribal Income.**

Income tax statutes do not tax Indian tribes. The tribe is not a taxable entity. Tribal income not otherwise exempt from Federal income tax is includible in the gross income of the Indian tribal member when distributed or constructively received by him. See *Choteau v. Commissioner*, 283 U.S. 691 (1931), Ct. D. 352, C.B. X-1, 355 (1931). Amounts paid to tribal council members or officers are subject to income tax. Rev. Rul. 59-354, C.B. 1959-2, 24; *Commissioner v. Walker*, 326 F. (2d) 261 (1964).

Absent a provision in a treaty or statute to the contrary, income directly derived by a member of an Indian tribe from unallotted Indian tribal lands is subject to Federal income tax. Rev. Rul. 58-320, C.B. 1958-1, 24; *Bentley L. Holt*, 44 T.C. 686 (1965), affirmed 364 F. (2d) 38 (1966), certiorari denied, 386 U.S. 931 (1967).

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subject to federal income tax. However, a corporation organized by an Indian tribe under state law does not share the same tax status as the tribe for federal income tax purposes and is subject to federal income tax on any income earned, regardless of the location of the business activities that produced the income.

Accordingly, Tribe T in Situation 1 and Corporation X in Situation 2 are not taxable entities and are not subject to federal income tax on any income earned from their business activities. Corporation Y in Situation 3 is a taxable entity and is subject to federal income tax on all income earned from its business activities.

#### **HOLDING**

An unincorporated Indian tribe or an Indian tribal corporation organized under Section 17 of the IRA is not subject to federal income tax on the income earned in the conduct of commercial business on or off the tribe's reservation. However, a corporation organized by an Indian tribe under state law is subject to federal income tax on the income earned in the conduct of the commercial business on and off the tribe's reservation.

This revenue ruling deals only with federal income taxes. It does not affect the application of other federal taxes, such as employment taxes and excise taxes (including excise taxes on wagering), to Indian tribes or tribal corporations.

#### **PROSPECTIVE APPLICATION**

Pursuant to Section 7805(b) of the IRC, the portion of the holding of this revenue ruling that applies to a corporation organized by an Indian tribe under state law will not be applied to income earned before October 1, 1994, from activities conducted within the boundaries of the reservation (including gain or loss properly allocable to such activities from the sale or exchange of assets).

#### **EFFECT ON OTHER RULINGS**

Rev. Rul. 81-295 is clarified. Rev. Rul. 67-284 is amplified.

#### **DRAFTING INFORMATION**

The principal author of this revenue ruling is Johnnel St. Germain of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. St. Germain at 202/622-4930.

## REVENUE PROCEDURE. 84-37

1984-1 C.B. 513; 1984 IRB LEXIS 429 (JANUARY, 1984)

### SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidance as to the manner in which a governmental unit of an Indian tribe or a political subdivision of an Indian tribal government not included among those listed in Revenue Procedures previously published by the IRS can request a determination qualifying it for treatment as a state or a political subdivision of a state as provided under section 7871 of the Internal Revenue Code (IRC).

### SEC. 2. BACKGROUND

.01 The Indian Tribal Governmental Tax Status Act of 1982, (Title II of Pub. L. No. 97-473, 96 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1981-1 C.B. 510, 511]) added certain provisions to the IRC that pertain to the status of Indian tribal governments. For two years beginning in 1983, Indian tribal governments (or subdivisions thereof) will be treated as states (or political subdivisions thereof) for specified federal tax purposes. For example, under new Section 7871 of the IRC interest on public activity bonds issued during the years 1983 and 1984 by a tribal government may be tax exempt, and a tribal government will be entitled to exemption from certain excise taxes. Also, charitable contributions made in 1983 and 1984 to or for the use of a tribal government may be deductible under federal gift and estate tax laws. Charitable contributions made during a taxpayer's tax years beginning in 1983 and 1984 may be deductible under the federal income tax laws.

.02 The term "Indian tribal government" is defined under Section 7701(a)(40) of the IRC (as amended) to mean the governing body of any tribe, band, community, village or group of Indians, or (if applicable) Alaska Natives, that is determined by the Secretary of Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions. Section 7871(d) of the IRC provides that, for purposes of section 7871, a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the Secretary of the Treasury determines (after consultation with the Secretary of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

.03 Three generally accepted sovereign powers of states are the power to tax, the power of eminent domain and the police power. See Rev. Rul. 77-164, 1977-1 C.B. 20; Rev. Rul. 77-165, 1977-1 C.B. 21; and Rev. Rul. 61-181, 1961-2 C.B. 21. Section 7871(d) of the IRC provides that a subdivision of an Indian tribal government shall be treated as a political subdivision of a state under certain circumstances. A subdivision of an Indian tribal government that has been delegated one of the generally accepted sovereign powers may qualify as a political subdivision of a state for purposes of 7871(d) of the IRC.

.04 A list of Indian tribal entities that exercise governmental functions for purposes of section 7871 of the IRC has been published as Revenue Procedure 83-87, 1983-2 C.B. 606.

.05 A list of Indian tribal subdivisions has been published as Rev. Proc. 84-36, page 510, this Bulletin.

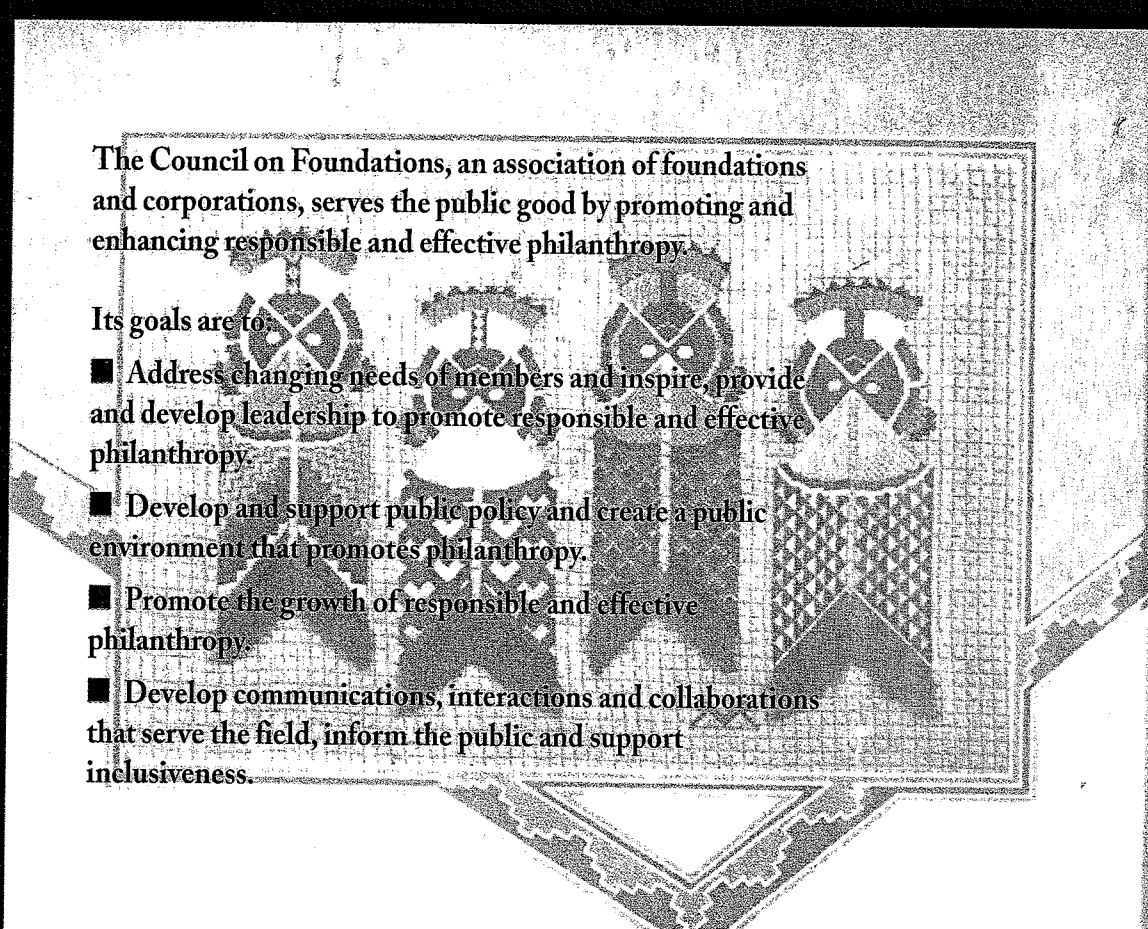
### **SEC. 3. APPLICATION**

.01 If a tribal entity or tribal subdivision is not included in Rev. Proc. 83-87 or Rev. Proc. 84-36, a request for recognition as such should be submitted in the form of an application for a private letter ruling in accordance with Rev. Proc. 84-1.

.02 All determinations will be made based on all the facts and circumstances. Each request should include an explanation how the entity satisfies the statutory definition of an Indian tribal government or to what extent the entity has been delegated one or more of the sovereign powers that would qualify it as an Indian tribal subdivision. Each request should also provide the actual or approximate date on which such entity satisfied the statutory definition of an Indian tribal government or was delegated one or more of the sovereign powers of an Indian tribal government. The explanation should be sufficiently detailed to show to the satisfaction of the Commissioner that the entity in question qualifies as a governmental unit of an Indian tribe or a political subdivision of an Indian tribal government.

.03 Each determination will specify whether or not the entity qualifies as an Indian tribal government (or subdivision thereof) and the date on which such determination is effective for purposes of section 7701 and 7871 of the IRC.

.04 Requests for determination that an Indian tribal government qualifies for treatment as a state or that a subdivision of an Indian tribal government qualifies for treatment as a political subdivision of a state as provided under Section 7871 of the IRC should be sent to: Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, Room 6545, 1111 Constitution Avenue, NW, Washington, DC 20224.



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