

# TRIBAL BONDAGE: STATUTORY SHACKLES AND REGULATORY RESTRAINTS ON TRIBAL ECONOMIC DEVELOPMENT

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## INTRODUCTION

*Promoting economic development is a traditional and long accepted governmental function, and there is no principled way of distinguishing it from the other public purposes the Court has recognized.*<sup>1</sup>

Just like state and local governments, Indian tribes, as separate sovereign governments, have an obligation to improve the lives of their citizens. When such governmental entities engage in economic development activities to elevate the economic status of their constituencies, they often seek outside funding to finance those activities. Many tribal governments, however, are still suffering from the impacts of deleterious historical federal policies.<sup>2</sup> Additionally, tribal communities are often burdened with extremely low socio-economic factors, including low

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<sup>1</sup> Kelo v. City of New London, 125 S.Ct. 2658 (2005).

<sup>2</sup> See Part II *infra*

educational achievement,<sup>3</sup> high unemployment,<sup>4</sup> high poverty,<sup>5</sup> and low per capita income.<sup>6</sup> For many tribes the only sources of capital to address these problems are limited to grants and other assistance from the federal government, but such funds are often insufficient to address the myriad responsibilities facing tribal governments.<sup>7</sup>

Contrary to popular belief, gaming does not provide sufficient funds to meet the needs of all tribal governments, as most of the more than 560 federally recognized Indian tribes<sup>8</sup> do not have any form of gaming operations,<sup>9</sup> and of those that do, only a small handful generate significant revenues.<sup>10</sup> While a small number of tribes near major metropolitan centers have started successful gaming enterprises, hundreds of tribes have not entered the gaming industry, and many that have participated actually operate casinos located far from population centers.<sup>11</sup> Most reservations are characterized by extensive land bases, spread out communities, and homesteads mired in one long-standing poverty cycle.<sup>12</sup> In fact, the need for economic development in Indian Country remains acute and impacts nearly every aspect of reservation life, as most Indian tribes have an economy that is on par with third world countries. The unemployment rate, for example, hovers around 50 percent for Indians who live on reservations, nearly ten times that for the nation as a whole, and almost one third of American Indians live in poverty.<sup>13</sup>

All too many tribal governments lack the ability to provide the basic infrastructure most U.S. citizens take for granted, such as passable roadways, affordable housing, and the plumbing, electricity, and telephone services that come with a modern home. According to the U.S. Census Bureau, approximately 20% of American Indian households on reservations lack complete plumbing facilities, compared to 1% of all U.S. households. About 1 in 5 American Indian reservation households dispose of sewage by means other than public sewer, septic tanks, or

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<sup>3</sup> Raymond C. Etcity, *Report of the Advisory Committee on Tax Exempt and Government Entities (ACT)*, p. II-7.

<sup>4</sup> Average unemployment on Indian reservations is 13.6% (with some reservations having unemployment levels above 50%). The general U.S. population has unemployment rate of 5.8%. See U.S. Census Bureau 2000.

<sup>5</sup> The average percentage of American Indians living in poverty is 25.67%, compared 12.38% for the general population. See U.S. Census Bureau 2000.

<sup>6</sup> Per capital income for American Indians is \$12,893.00, compared to the overall U.S. average of \$21,587.00. See U.S. Census 2000.

<sup>7</sup> Etcity at p. II-7

<sup>8</sup> "Indian Entities Recognized and Eligible to Receive Services from the United States Bureau of Indian Affairs," *Federal Register*, November 25, 2005 (Volume 70, Number 226), p. 71193

<sup>9</sup> According to the National Indian Gaming Association, only 217 tribes have gaming operations of any kind (cite to NIGA stats).

<sup>10</sup> See National Gambling Impact Survey Commission Report, p. 2-10 ("The 20 largest Indian gambling facilities account for 50.5 percent of total revenues, with the next 85 accounting for [only] 41.2 percent. Additionally, not all gambling facilities are successful. Some tribes operate their casinos at a loss and a few have even been forced to close money-losing facilities.")

<sup>11</sup> See Donald L. Barlett and James B. Steele, *Wheel of Misfortune*, *TIME*, December 16, 2002.

<sup>12</sup> "Entrepreneurial Sector is the Key to Indian Country Development," *Indian Country Today*, September 6, 2002 at p. A2.

<sup>13</sup> See Tex Hall, *The Native American Capital Formation and Economic Development Act of 2003: Testimony on Senate Bill 519, 2003.*

cesspool.<sup>14</sup> The Navajo reservation is the same size as West Virginia, yet it only has 2,000 miles of paved roads while West Virginia has 18,000 miles.<sup>15</sup> Obviously, roads, telephones, electricity, and the like are taken for granted by investors and employers even in the most distressed inner cities of the United States. Their absence from large portions of Indian country poses a daunting barrier to tribal leaders' attempts to attract new private sector investment and jobs.

Such realities highlight the importance of stimulating economic development to create economic opportunity for tribal members. Many scholars, investors, and tribal officials charged with developing their economies are well aware that access to capital for tribes and individual Indian entrepreneurs is a significant and pressing problem. The unanswered question is one of capital formation: How do tribes obtain the necessary capital to build a permanent economic base? The answer should be to access the capital markets in the same way that state and local governments do to finance their own economic development activities, but as this article will demonstrate, severe impediments to a level playing field continue to plague Indian Country.

State and local governments obtain revenues to finance their operations primarily through three channels: tax revenues, borrowing, and federal grants.<sup>16</sup> Borrowing has increasingly become a favored method of raising revenue for state and local governments.<sup>17</sup> These entities may, with some exceptions, issue so called "tax-exempt" bonds.<sup>18</sup> This tax-exempt status of municipal bonds has been a part of the Federal Tax Code since its adoption in 1913.<sup>19</sup> Fippinger explains that a tax-exempt bond is "a debt security in which the interest portion of the debt service paid is not included in gross income."<sup>20</sup> The tax-exempt status of municipal debt allows state and local governments to issue bonds at lower interest rates, since the income from those bonds results in the same net level of income for taxpayers in higher tax brackets.

To illustrate this phenomenon, assume that a taxpayer whose effective tax rate is 40 percent purchases a \$1000 taxable bond from a corporation that pays interest of 10 percent. She will receive an annual interest payment of \$100, but she must

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<sup>14</sup> Statistical Brief, Housing of American Indian on Reservations - Plumbing, 1995, Bureau of the Census

<sup>15</sup> Michael J. Kurman, *Indian Investment and Employment Tax Incentives*, 41 FED. B. NEWS & J. 578 (1994).

<sup>16</sup> M. David Gelfand, STATE AND LOCAL GOVERNMENT DEBT FINANCING, §1.04, Clark Boardman Callaghan (2003)

<sup>17</sup> Such obligations fall under the heading of "municipal securities" in Section 3(a)(29) of the 1934 Act. The applicable definition under this section for our purposes describes a municipal security as "direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more states..." Therefore, municipal security or municipal debt, when used in this article, can refer to a state, municipality, or an agency or instrumentality of either.

<sup>18</sup> I.R.C. §103 (1986).

<sup>19</sup> Eric J. Gouvin, *Radical Tax Reform, Municipal Finance, and the Conservative Agenda*, 56 RUTGERS L. REV. 409, 424 (2004).

<sup>20</sup> Robert A. Fippinger, THE SECURITIES LAW OF PUBLIC FINANCE, §1:2.2, Practising Law Institute (2002).

pay \$40 of that in taxes, resulting in a net income of \$60. If she were to purchase a \$1000 tax-exempt bond from a municipality that pays 6 % in interest, she would still receive \$60 and would be economically indifferent between the two bonds, assuming that all other attributes of the bonds were equivalent, such as the risk of default and the dates of payment. Thus, the municipality can raise the same amount of capital as the corporation for substantially less in interest expense.

Unfortunately, such advantage is not universally available in Indian Country. While many tribal economies still resemble those of a third world country, a small number of tribal economies have been able to expand,<sup>21</sup> and approximately 15% of the tribes<sup>22</sup> have been able to obtain debt financing from a variety of lenders<sup>23</sup> to finance economic development activities and infrastructure improvements.<sup>24</sup> Most tribes, however, are still unable to access the capital markets competitively, if at all. A primary roadblock to capital markets is the discriminatory provisions of the 1982 Indian Tribal Governmental Tax Status Act (“Tribal Tax Status Act”),<sup>25</sup> part of the Internal Revenue Code (“Tax Code”). While the goal of the Tribal Tax Status Act was to treat tribes just as states are treated in the Tax Code,<sup>26</sup> the act falls far short of achieving the goal of equal treatment desired by tribes,<sup>27</sup> and in fact substantially limits the ability of tribes to raise debt for economic development activities. Although the Tribal Tax Status Act extended “certain tax provisions to American Indian Tribal governments on the same basis as such provisions apply to States,”<sup>28</sup> it did not recognize tribes as equivalent to states for *all* tax purposes, specifically denying them the elements of public finance that they desired most.<sup>29</sup>

While the federal policy of exempting from federal taxation interest paid on state bonds issued to finance and effectuate state policy is a recognition and affirmation of that state’s sovereignty, a similar recognition and affirmation of sovereignty unfortunately does not extend to Indian tribes because tribes face two additional restrictions that do not apply to their state and local governmental counterparts. In the first instance, unlike state and local governments, Indian tribes

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<sup>21</sup> See FELIX COHEN’S HANDBOOK OF AMERICAN INDIAN LAW, 2005 ed., §21.03, hereinafter HANDBOOK III (Professor Clarkson was a contributing author for this most recent edition of the HANDBOOK, providing material on tribal finance, tribal corporations, economic development, and intellectual property). Two earlier editions of the Handbook are also referenced in this article. Felix Cohen’s original Handbook was published in 1941 (hereinafter HANDBOOK I). The Handbook was substantially revised and reissued in 1982 (hereinafter HANDBOOK II).

<sup>22</sup> IRS Research Summary, on file with the author. This research summary is the result of a joint research project between the author and the Tax Exempt Bonds division of the IRS.

<sup>23</sup> Fitch Ratings Report, “Tribal Governments in the Bond Market,” February 4, 2004, p. 1

<sup>24</sup> Townsend Hyatt, Perry E. Israel, Alan Benjamin, *An Introduction to Indian Tribal Finance* (published by Orrick, Herrington & Sutcliffe LLP) 2004. See also HANDBOOK III, §21.03.

<sup>25</sup> Title II of Pub. L. No. 97-473, 96 Stat. 2608 (1982) (codified at I.R.C. §7871) (2004) [hereinafter Tribal Tax Status Act].

<sup>26</sup> See 127 Cong. Rec. S5666, S5667 (daily ed. June 2, 1981) (remarks of Sen. Wallop (R-Wyo.)).

<sup>27</sup> See, e.g., Robert A. Williams, *Small Steps on the Long Road to Self-Sufficiency for Indian Nations: The Indian Tribal Governmental Tax Status Act of 1982*, 22 HARV. J. ON LEGIS. 335 (1985); Ellen P. Aprill, *Tribal Bonds: Indian Sovereignty and the Tax Legislative Process*, 46 ADM. L. REV. 333 (Summer 1994).

<sup>28</sup> Senate Report No. 97-646 (1982), section I (summary).

<sup>29</sup> See HANDBOOK III *supra* note 21, §21.03[2][c].

cannot issue private activity bonds.<sup>30</sup> Worse, however, is the Tribal Tax Status Act's "additional requirement"<sup>31</sup> that tribal tax-free bond proceeds only be used for "essential governmental functions,"<sup>32</sup> a restriction not applicable to state and municipal bonds.<sup>33</sup>

The damage to tribal economic prospects was compounded when the act was amended in 1987 to clarify that tribes can only issue tax-free bonds for projects "customarily"<sup>34</sup> financed by states and local governments (e.g., schools, roads, government buildings, etc.).<sup>35</sup> Thus, Indian tribes can only issue tax-exempt debt if "substantially all" of the borrowed proceeds "are to be used in the exercise of any essential governmental function."<sup>36</sup> In addition, section 7871(e) states that "the term 'essential governmental function' shall not include any function which is not customarily performed by State and local governments with general taxing powers" but does not provide any guidance as to when a particular activity becomes "customary" for a municipal government. As the tax-base of a tribe is usually insufficient for a tribe to issue general obligation bonds<sup>37</sup> and since the revenue from a revenue bond is usually linked to the project being financed,<sup>38</sup> this additional restriction to "customary" governmental activity places tribes at a tremendous disadvantage relative to the capital markets and is inequitable when compared to other forms of municipal debt.

The narrow interpretation of this language by the Internal Revenue Service ("IRS") has had a demonstrably stifling effect on tribes' tax-free bonding authority.<sup>39</sup> These restrictions on the scope of what can be financed with tax-exempt debt in particular deny poor tribes the opportunity to address their glaring infrastructure and economic development needs. Tribes with substantial natural resources or significant gaming operations have the option of financing certain activities on a taxable basis even if, absent a restrictive Tax Code, they would be able to finance those activities on a tax-exempt basis. Poorer tribes, however, do not have that luxury, and upwards of \$50 billion in annual capital needs go unmet in Indian Country,<sup>40</sup> in part because the debt service required to finance the

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<sup>30</sup> See Williams *supra* note 27, at 382; Aprill *supra* note 27 at 335; see also Hyatt, Israel, *et al*, *supra* note 24, p. 19 ("State and local governments often issue tax-exempt private activity bonds for the benefit of nonprofit corporations, or to finance mortgage loans for first-time low- and moderate-income home buyers, or to finance low- and moderate-income residential rental property. Private activity bonds are also issued for airports, docks, and wharves, solid waste facilities, sewage facilities, and certain other facilities."). Under current law, Indian tribes are barred from issuing private activity bonds for anything other than a tribal manufacturing facility. 26 USC §§7871(c)(2)-(c)(3).

<sup>31</sup> I.R.C. §7871(c).

<sup>32</sup> I.R.C. §7871(c)(1).

<sup>33</sup> See HANDBOOK III *supra* note 21, §21.03[2][c].

<sup>34</sup> I.R.C. §7871(e).

<sup>35</sup> See H. R. No. 100-391 at 1139, 100<sup>th</sup> Cong., 1<sup>st</sup> Sess. (1987).

<sup>36</sup> 26 USC §7871(c)(1). "Substantially all" is not defined in the statute but is believed to mean at least 95% of the proceeds. See Hyatt, Israel, *et al*, *supra* note 24, p. 18

<sup>37</sup> See Williams *supra* note 27, at 385 ("few Indian communities enjoy the thriving economic environment necessary to sustain a stable tax base").

<sup>38</sup> See Aprill *supra* note 27, at 342.

<sup>39</sup> See HANDBOOK III *supra* note 7, §21.03[2][c].

<sup>40</sup> See Henson, E. and J. Taylor, *Native America at the New Millennium*, Harvard Project on

projects to meet those needs is too expensive at taxable rates.<sup>41</sup>

The deleterious impact of these discriminatory restrictions can be seen in the relative paucity of tribal tax-exempt financings. For the years 2002, 2003, and 2004, state and local governments issued an average of 14,038 tax exempt bonds.<sup>42</sup> Over the same period, tribal governments annually issued an average of five tax-exempt bonds.<sup>43</sup> In dollar terms, for the years 2002-2004, state and local governments issued on average \$363.6 billion of tax-exempt debt<sup>44</sup> while tribal governments issued on average only \$202 million of tax-exempt debt.<sup>45</sup>

Given the relative numbers of municipal and tribal issuers,<sup>46</sup> the expected number of tribal tax-exempt issues should be more than an order of magnitude higher. American Indians account for more than 1.5% of the national population, yet tribes issue less than one tenth of one percent of the tax-exempt bonds each year.<sup>47</sup>

	2002 Issues	2002 Par Amount (US\$ mil)	2003 Issues	2003 Par Amount (US\$ mil)	2004 Issues	2004 Par Amount (US\$ mil)
State authority	1,943	125,595.7	1,978	119,013.3	1,884	102,837.4
Local authority	2,109	59,156.1	2,141	62,572.7	1,837	57,197.4
District	4,351	54,509.7	4,613	56,560.5	4,298	58,235.3
City, Town or Village	4,062	46,948.4	4,330	54,526.9	3,782	53,368.7
State	272	34,042.4	262	48,401.7	241	47,042.6
County /Parish	1,047	23,325.1	1,146	24,479.3	961	23,182.0
College or University	199	7,045.9	226	8,929.4	235	8,860.1
Direct Issuer	69	3,991.1	56	4,244.1	68	5,781.3
Co-op Utility	4	930.0	-	-	-	-
Indian tribe	4	194.4	6	233.2	5	178.4
<b>Total</b>	<b>14,056</b>	<b>355,544.4</b>	<b>14,752</b>	<b>378,727.9</b>	<b>13,306</b>	<b>356,504.8</b>

American Indian Economic Development Working Paper, 2003.

<sup>41</sup> Testimony of Dr. Gavin Clarkson before the Senate Finance Committee, May 23, 2006.

<sup>42</sup> See Thomson Financial data extract on file with author. For 2002, 2003, and 2004, state and local governments issued 14,056, 14,752, and 13,306 tax-exempt short and long-term bonds respectively. *Id.*; See also BOND BUYER ONLINE ARCHIVES, ANNUAL MUNICIPAL DEBT SALES, LONG TERM BONDS, NUMBER OF ISSUES and ANNUAL MUNICIPAL DEBT SALES, SHORT TERM BONDS, NUMBER OF ISSUES, available at, [http://www.bondbuyer.com/msa\\_displayquickreport.html](http://www.bondbuyer.com/msa_displayquickreport.html) (last viewed 12/12/2005), stating that for 2002, 2003, and 2004, state and local governments issued 12,517, 13,251, and 11,993 tax-exempt long term bonds respectively and for 2002, 2003, and 2004, state and local governments issued 3,435, 3,300, and 3,172 tax-exempt short term bonds respectively.

<sup>43</sup> See Thomson Financial data extract. For 2002, 2003, and 2004, tribal governments issued 4, 6, and 5 tax-exempt short and long-term bonds respectively. *Id.*; See also BOND BUYER ONLINE ARCHIVES, LONG TERM BONDS, *supra*, note ; BOND BUYER ONLINE ARCHIVES, SHORT TERM BONDS, *supra*, note . For the years 2002, 2003, and 2004, tribal governments issued 6, 9, and 5 long term bonds respectively. For the years 2002, 2003, and 2004, tribal governments issued 0, 0, and 1 short term bonds respectively. (These Bond Buyer tribal bond statistics likely include some taxable bonds and therefore the Thomson figures provide a more accurate picture of tribal tax-exempt debt issuances).

<sup>44</sup> *Id.* For 2002, 2003, and 2004, state and local governments issued \$355.5 trillion, \$378.9 trillion, and \$356.5 trillion dollars of tax-exempt debt respectively. *Id.*

<sup>45</sup> *Id.* For 2002, 2003, and 2004, tribal governments issued \$194.4 million, \$233.3 million, and \$178.4 million dollars of tax-exempt debt respectively. *Id.*

<sup>46</sup> There are 565 federally recognized Indian Tribes and Alaskan Native Villages that could potentially issue municipal debt, as compared to 3,141 counties, \_\_\_\_\_ cities, and 50 states. If \_\_\_\_\_ percent of all municipal issuers issue bonds each year, then the expected number of tribal issuers is \_\_\_\_\_, well short of the average of 5 per year.

<sup>47</sup> Clarkson testimony, *supra* note 41.

Although many municipal bonds fund infrastructure projects, a significant number fund projects related to tourism and economic development. Tourism is a major economic force for many municipalities and is vital to the economic prospects of several communities. As an example, post-Katrina New Orleans is almost wholly dependent on a rebound in tourism for its long-term economic viability. Tourism and tourism-related economic development can include hotels, golf resorts, convention centers, and even racetracks and casinos. In particular, the IRS has acknowledged that several thousand municipal golf courses have been financed with tax-exempt debt,<sup>48</sup> and non-tribal governments have used billions of tax-exempt bonds to build hotels and convention centers.<sup>49</sup> The IRS has even issued recent rulings to permit tax-exempt financing for new baseball stadiums for the New York Yankees and the New York Mets, citing an earlier Revenue Ruling which held that the promotion of tourism was an “exclusively public purpose.”<sup>50</sup> Nevertheless, tourism and tourism-related economic development cannot be financed by tribes with tax-exempt debt.

Repurchasing ancestral homeland is another potential use for tax-exempt bonds, yet statutory restrictions and the extreme interpretation by the IRS have resulted in some highly unfortunate outcomes. In one instance, a tribe was interested in repurchasing some ancestral homeland adjacent to land that it already owned.<sup>51</sup> Unfortunately, the land in question was farmland with an existing crop of corn nearing maturity. The tribe wanted to issue tax-exempt bonds to purchase the land but was advised that if they harvested the corn, the tax-exempt status of their bonds could be jeopardized. The tribe was forced to let the corn rot in order to preserve the tax-exempt status of the bonds.

In another case, a tribe had the opportunity to repurchase 23,000 acres of ancestral homeland for approximately \$5.5 million.<sup>52</sup> Most of the land in question had been over forested, but a small section containing harvestable timber remained that would help the tribe afford the land purchase. Again, the restrictions in the Tax Code meant that the tribe would not be able to harvest timber on the land, and they could barely afford the interest payments even at tax-exempt rates. The author, along with another colleague were fortunately able to develop a structure that allowed the tribe to afford the necessary debt service, and the tribe was able to purchase the land.

The IRS’s restrictive interpretation of tribal tax-exempt bonding authority has also meant a substantially higher audit risk for tribal bonds, as tribal governments are also victims of a demonstrably disproportionate number of IRS enforcement actions. Less than 1% of the tax-exempt municipal offerings are audited by the IRS

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<sup>48</sup> Cite to IRS FSA

<sup>49</sup> See Part III.C.2. *infra*.

<sup>50</sup> See IRS PLR 110172-06 and 107899-06. These private letter rulings concluded that the public purpose requirement is satisfied in part by the promotion of tourism, citing Rev. Rul. 72-194, which held the promotion of tourism to be an “exclusively public purpose.” These rulings are wholly inconsistent with the position the IRS has been taking with respect to the operation of tribal golf courses and hotels, which the IRS argues are not essential governmental functions.

<sup>51</sup> Interview with Robert Burpo of First American Financial Advisors on March 9, 2005.

<sup>52</sup> See Offering Memorandum for Bad River Band of Lake Superior Chippewa, on file with the author.

each year, but direct tribal tax-exempt issuances are 30 times more likely to be audited within four years of issue,<sup>53</sup> and 100% of tribal conduit issuances have been or are currently being challenged by the IRS.<sup>54</sup> In all of these cases, the tribes financed activities that had previously been financed by state and local governments without any challenge from the IRS. While the National Congress of American Indians and the National Intertribal Tax Alliance have worked to remove these inequities for years,<sup>55</sup> even the venerable Wall Street firm of Merrill Lynch is on record decrying the inequity of the tax treatment of tribes relative to municipalities.<sup>56</sup> This high rate of tribal audits becomes even more questionable when one realizes that tribal tax-exempt issuances make up only 0.1% of the tax-exempt bond market.<sup>57</sup>

One of the more egregious examples of hostile and adverse treatment of a tribe is the case of the Las Vegas Paiute Tribe. The tribe was not in a position to compete in the gaming market, but they did have sufficient land thirty miles north of Las Vegas to develop a golf course. The Paiutes used proceeds from a tax-free bond issuance to finance construction of a public golf course with a clubhouse, a retail store that sells golf-related items, and a restaurant, all of which were open to the general public.<sup>58</sup> The tribe had good reason to believe that construction of a public golf course would qualify as an essential governmental function “customarily performed by state and local governments,”<sup>59</sup> given that “as of 1998 there were 2,645 publicly owned, municipal golf courses in the United States.”<sup>60</sup>

In August of 2002, however, the IRS advised the Las Vegas Paiutes that construction of a public golf course is “other than an essential governmental function within the meaning of § 7871(e).”<sup>61</sup> Although the IRS acknowledged that “it is likely that construction and operation of golf courses are customary governmental functions,” it nonetheless decided to deny the tax-exemption based on its reading of the customary use definition provided by the 1987 amendment.

The argument set forth by the IRS was that the golf course was not “intended to meet the recreational needs of [the] Tribe.”<sup>62</sup> Although other public golf courses can be considered essential governmental functions, the IRS took the position that Indian tribes cannot utilize tax-free debt to construct golf courses and accompanying club houses because, in its opinion, the course was not of the type that would be used by tribal golfers. The Field Service Advice Memorandum (“FSA”) admits that all publicly built and operated golf courses “are developed to enhance the lifestyle of both golfing and non-golfing citizens of the community

<sup>53</sup> IRS Research Summary

<sup>54</sup> See Alison L. McConnell, *IRS' Anderson Says Attorneys At Fault for Tribal Bond Confusion*, BOND BUYER, September 22, 2005; see discussion of IRS enforcement at Part IV.E *infra*.

<sup>55</sup> NCAI and NITA citations

<sup>56</sup> See e.g. Merrill Lynch Municipal Credit Research, “Indian Gaming Bond Pricing Update,” May 24, 2004 (tribes are forced to contend with “inequities in the Tax Code”)

<sup>57</sup> See discussion of IRS enforcement at Part IV.E *infra*.

<sup>58</sup> IRS Field Service Advice Memorandum No: 20024712 (date of release Nov. 22, 2002) [hereinafter FSA].

<sup>59</sup> I.R.C. § 7871(e)

<sup>60</sup> FSA at 2.

<sup>61</sup> FSA at 1.

<sup>62</sup> FSA at 5.

and perhaps to create jobs,”<sup>63</sup> and in-house counsel recommended not litigating the bond exemption because it would “be difficult to argue that Golf Course is so commercial in nature that state and local governments would not own and operate similar enterprises.”<sup>64</sup> Additionally, the FSA acknowledged that “some courts, including the Tenth Circuit, have adopted the principle that federal statutes are to be construed liberally in favor of Native Americans, with ambiguous provisions interpreted to their benefit.”<sup>65</sup> In short, the IRS’ position was untenable based on existing public practices and judicial rulings, but it denied the tax-exemption anyway.

In a sharp contrast to its approach in the 2002 FSA to defining an essential governmental function as excluding any commercial activity, the IRS has reasoned that a state investment fund for cash balances constituted an essential governmental function because “it may be assumed that Congress did not desire in any way to restrict a state’s participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.”<sup>66</sup> Thus, for purposes of section 115, the IRS has, without intervention by Congress, defined as an essential governmental function any activity that makes or saves the government money. This definition encompasses the very purpose of the Las Vegas Paiute Golf Course which the IRS has reasoned does not qualify as an essential governmental function.<sup>67</sup>

The Las Vegas Paiute case is merely one example of the overt hostility towards tribal governments from both the Tax Code and the IRS enforcement regime. This article argues that, when compared to the treatment of other governmental entities, such differential treatment can appropriately be characterized as Tax Code Racism.

Of course, referring to a practice of adverse and differential treatment as racism is not a charge to be levied lightly because an accusation of racism is one of the most incendiary charges that can be leveled in our society. To do so armed with empirical evidence, however, falls directly in line with Professor Robert Williams’ strategy of “direct confrontation that challenges the continuing use of racial stereotypes [and imagery] in thinking and talking about Indian rights by the Court [and] the U.S. Congress.”<sup>68</sup> As Williams notes, the use of such empirical evidence was also a strong component of the successful strategy employed in *Brown v. Board of Education*.<sup>69</sup> One challenge in discussing racism, however, is that the precise meaning of “racism” is often not agreed upon.<sup>70</sup> In order to clarify the

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<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> See John F. Theberge and Diana A. Imholtz, *Tax-Exempt Financings Involving Indian Tribal Governments*, The Tax Exempt Organization Tax Review 182, August 2003 (quoting Rev. Rul. 77-261).

<sup>67</sup> FSA at 5.

<sup>68</sup> Robert A. Williams, *LIKE A LOADED WEAPON: THE REHNQUIST COURT, INDIAN RIGHTS, AND THE LEGAL HISTORY OF RACISM IN AMERICA* (2005) (hereinafter *LOADED WEAPON*), p. xxviii.

<sup>69</sup> *Id.* at xxxii, n58.

<sup>70</sup> See K. Anthony Appiah, forward to Albert Memmi *RACISM* (2000), p. ix (“careful attempts at

charge, this article will use an objective definition of racism based on the writings of Albert Memmi.<sup>71</sup> Various scholars have attempted to define racism, but many of these attempts have been cast in terms of black-white interactions.<sup>72</sup> When dealing with issues involving Indian tribes, entities with both racially and politically defining characteristics, Memmi's typology of racism provides a framework for defining racism that has significant utility in examining the actions and perceptions of dominant society relative to Indian tribes.<sup>73</sup>

Memmi was a Tunisian Jew whose perception of racism was heavily influenced both by his membership in a group that had a long history of being subjected to European racism and imperialism as well as his experience of being a Jew in a predominantly Arab country. Memmi also personally suffered under the power of European colonialism and racism, particularly when he was imprisoned in a Nazi work camp during World War II. Based on these and other experiences, Memmi proposed the following definition of racism:

the generalizing definition and valuation of differences, whether real or imaginary, to the advantage of the one defining and deploying them [accuser], and to the detriment of the one subjected to the act of definition [victim], whose purpose is to justify (social or physical) hostility and assault [aggression].<sup>74</sup>

His analysis also discusses four essential "moments" of racism:

1. An insistence on difference, whether real or imaginary. The perceived difference can be somatic, cultural, religious, etc.; the emphasis is on the discernment of its existence, rather than its nature or content.
2. The imposition of a negative valuation upon those seen as differing, implying (by the act of imposition) a positive valuation for those imposing it.
3. This differential valuation rendering the difference unignorable is made absolute by generalizing to an entire group that is then deprecated in turn.
4. The negative valuation imposed upon that group becomes the legitimization and justification for present or possible hostility, aggression, or privilege.<sup>75</sup>

The power of Memmi's typology of racism lies in the fact that his definition does not require that the perceived differences be only biological in nature, as (real or imaginary) cultural differences could just as easily be used to justify aggression or privilege as could biological differences. Such has been the case with Indian tribes, as many of the policies directed towards them were based on a hostile

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a definition [of racism] are surprisingly rare").

<sup>71</sup> See e.g. Albert Memmi *RACISM* (2000).

<sup>72</sup> See e.g. Jody David Armour, *NEGROPHOBIA AND REASONABLE RACISM: THE HIDDEN COST OF BEING BLACK IN AMERICA* (1997); Joel Kovel, *WHITE RACISM: A PSYCHOHISTORY*, \_\_\_ (1970).

<sup>73</sup> See generally Williams, *LOADED WEAPON*, *supra* note 68; Robert A. Williams, *Documents of Barbarism: The Contemporary Legacy of European Racism and Colonialism in The Narrative Traditions of Federal Indian Law*, 31 *ARIZ. L. REV.* 237 (1989)

<sup>74</sup> Memmi, *RACISM*, *supra* note \_\_\_ at 100. Memmi's original definition, presented in Memmi, *Attempt at a Definition*, in *DOMINATED MAN: NOTES TOWARD A PORTRAIT* (1968) at 185, was quite similar: "the generalized and final assigning of values to real or imaginary differences, to the accuser's benefit and at his victim's expense, in order to justify the former's own privileges or aggression."

<sup>75</sup> Memmi, *RACISM*, *supra* note \_\_\_ at xvii-xviii.

perception of tribalism<sup>76</sup> while others were based on negative perceptions of biological differences.<sup>77</sup>

Noted postcolonial theorist Homi Bhaba posits a similar notion of “colonial discourse,” suggesting that its use “as an apparatus of power, at a minimum, turns on the recognition and disavowal of racial/cultural/historical differences”<sup>78</sup> and that the “objective of colonial discourse is to construe the colonized as a population of degenerate types on the basis of racial origin, in order to justify conquest and to establish systems of administration and instruction.”<sup>79</sup>

Given the broad authority that the federal government has in managing Indian affairs, laws and policies based on racist notions are particularly deleterious when considering that dominant society’s perception of Indian tribes has often been racist in nature. Part I of this article discusses the nature of Indian tribes and their relationship to the federal government and makes the argument that while the United States is usually forced to deal with tribes on a government-to-government basis, racist attitudes fundamentally shape the nature of those interactions despite the inherent recognition of tribal sovereignty. While the charge of racism is levied against the Tax Code and its concomitant regulations, the tribes feel the impact of the alleged racism when they approach capital markets in competition with other governmental entities.

For those readers unfamiliar with public finance, Part II of this article introduces governmental access to the capital markets, including a discussion of the policy justifications for tax-free treatment of municipal debt. This section also identifies those elements of the public finance market that are either unavailable to tribes or are only available under restrictive conditions that apply to tribes but do not restrict other governmental entities. Although the last quarter century has seen many racist policies and laws replaced by a formal federal policy of tribal self-determination, the specter of racism still lurks in the shadows, occasionally rearing its ugly head. As mentioned earlier, one such instance that provides the basis for this article’s charge of Tax Code racism is the political and regulatory maneuvering during and after the passage of the Tribal Tax Status Act. Part III examines the legislative and regulatory history of this Act and its subsequent enforcement, providing detailed empirical evidence of demonstrably discriminatory treatment of tribal tax-exempt bonds. Having reviewed in detail the legislative history of the status quo as well as differential treatment of tribes and states in IRS audit and enforcement, the article continues in Part IV by applying Memmi’s typology of racism in examining the adverse impact of the Act. Although there is legitimate concern that leveling the charge of racism might cause some to dismiss the underlying merits of the arguments presented in this article, Williams correctly notes that “Indian rights will never be justly protected by any legal system or civil society that continues to talk about Indians as if they are

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<sup>76</sup> See Part III *infra*.

<sup>77</sup> *Id.*

<sup>78</sup> Homi K. Bhaba, *The Other Question: Stereotype, Discrimination, and the Discourse of Colonialism*, in *THE LOCATION OF CULTURE* (1994), p. 70.

<sup>79</sup> *Id.*

uncivilized, unsophisticated, and lawless savages.”<sup>80</sup> Merely substantiating the charge of racism is insufficient, however, so this article concludes by proposing specific statutory modifications that would eliminate the discriminatory elements in the Tax Code.

#### I. A BRIEF HISTORY OF TRIBAL LAW AND POLICY

The racist notions that led to the restrictions of tribal economic development are not new, as the discourse of racism against Indian tribes traces back to the origins of the United States itself.<sup>81</sup> In *Cherokee Nation v. Georgia*,<sup>82</sup> the first Supreme Court opinion involving an American Indian tribe,<sup>83</sup> Chief Justice Marshall wrote that “the relation of the Indians to the United States is marked by peculiar and cardinal distinctions which exist no where else.”<sup>84</sup> A half century later the Supreme Court would opine that the “relation of the Indian tribes living within the borders of the United States, both before and since the Revolution, to the people of the United States has always been an anomalous one and of a complex character.”<sup>85</sup> Even today, Supreme Court justices find that “Federal Indian policy is, to say the least, schizophrenic. And this confusion continues to infuse federal Indian law and our cases.”<sup>86</sup> The concept that so confounds both Congress and the courts is that, on one hand, Indian tribes are separate sovereigns, “domestic dependent nations”<sup>87</sup> that are ensconced as a “third sovereign”<sup>88</sup> in the federal framework. On the other hand, Congress has plenary authority over Indian tribes.<sup>89</sup> While the fabrication of this plenary authority has dubious origins,<sup>90</sup> the continued

<sup>80</sup> See Williams, *LOADED WEAPON*, *supra* note 68, p. xxviii. In comparing the struggle for Indian rights with the successful strategies employed by Thurgood Marshall in arguing *Brown v. Board of Education*, Williams argues that “the legal history of racism in American teaches us that the most successful minority rights advocates of the twentieth century recognized that the real waste of time was trying to get a nineteenth-century racist legal doctrine to do a better job of protecting minority rights.” *Id.* at xxxii.

<sup>81</sup> *Id.*, p. xxv.

<sup>82</sup> *Cherokee Nation v. Georgia*, 30 U.S. 1 (1831).

<sup>83</sup> An earlier Supreme Court case, *Johnson v. McIntosh*, 21 US 543 (1823), dealt with the issue of who could acquire title to land from Indian tribes, but no tribe was a party to the case.

<sup>84</sup> *Cherokee Nation* at 14.

<sup>85</sup> *United States v. Kagama*, 118 U.S. 375, 381 (1886).

<sup>86</sup> *United States v. Lara*, 541 U.S. 193, 219 (2004).

<sup>87</sup> *Cherokee Nation* at 14.

<sup>88</sup> In the words of Justice O’Connor, “Today, in the United States, we have three types of sovereign entities – The Federal government, the states, and the Indian tribes. Each of these sovereigns ... plays an important role ... in this country.” O’Connor, *Lessons from the Third Sovereign: Indian Tribal Courts*, 33 *Tulsa L.J.* 1, 1997.

<sup>89</sup> Handbook III § 1.03[1]

<sup>90</sup> Arguably, the Supreme Court simply made up the notion of plenary authority. In *Kagama*, the Court stated that

These Indian tribes are the wards of the nation. They are communities dependent on the United States. Dependent largely for their daily food. Dependent for their political rights . . . . From their very weakness and helplessness, so largely due to the course of dealing of the Federal Government with them and the treaties in which it has been promised, there arises the duty of protection, and with it the power. This has always been recognized by the Executive, and by Congress, and by this court, whenever the question has arisen.

*Id.* at 383–384. Unable to find a source for such plenary authority in the Constitution, the Court held that

maintenance of such authority is justified by a racist discourse based on a negative perception of tribalism.<sup>91</sup>

The acknowledged existence of tribal sovereignty, however, has served to impede the deleterious exercise of that plenary authority. While each tribe has its own separate history, the struggle to maintain a separate sovereign existence is common to most tribes. The economic importance of that struggle cannot be overstated, particularly in the modern context, as the “first key to economic development is sovereignty.”<sup>92</sup> It is important to review the origins of the federal Indian law and policy before addressing the modern context.

The schizophrenic dichotomy inherent in the notion of domestic dependent nations has been a part of the history of North America from the moment that Europeans first made contact with the Indians, in part because multiple competing sovereigns asserted claims in North America. Although the doctrines of conquest had their origins in legal theories developed to justify the Crusades,<sup>93</sup> when competing European nations began to expand their empires, the papacy began to grant exclusive rights to lands as they were “discovered,” including rights of sovereignty over the indigenous populations.<sup>94</sup>

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The power of the General Government over these remnants of a race once powerful, now weak and diminished in numbers, is necessary to their protection, as well as to the safety of those among whom they dwell. It must exist in that government, because it never has existed anywhere else, because the theatre of its exercise is within the geographical limits of the United States, because it has never been denied, and because it alone can enforce its laws on all the tribes.

*Id.* at 384–385.

<sup>91</sup> See, e.g., *Johnson v. McIntosh*, 21 U.S. 590 (1823) (“But the tribes of Indians inhabiting this country were fierce savages, whose occupation was war, and whose subsistence was drawn chiefly from the forest. To leave them in possession of their country, was to leave the country a wilderness . . .”); *Cherokee Nation v. Georgia*, 30 U.S. 1, 17 (1831) (“[Indians] are in a state of pupillage. Their relation to the United States resembles that of a ward to his guardian.”); *Worcester v. Georgia*, 31 U.S. 515, 588 (1832) (discussing the “humane policy of the government towards these children of the wilderness must afford pleasure to every benevolent feeling”). These three cases, often referred to as the “Marshall Trilogy,” form much of the foundation for federal Indian law.

<sup>92</sup> Steven Cornell, *Sovereignty, Prosperity and Policy in Indian Country Today*, 5 COMMUNITY REINVESTMENT 5, 5 (1997).

<sup>93</sup> See e.g. Pope Innocent IV, *Commentaria Doctissima in Quinque Libros Decretalium*, in *THE EXPANSION OF EUROPE: THE FIRST PHASE 191-192* (James Muldoon ed. 1977), (“[I]s it licit to invade a land that infidels possess or which belong to them? . . . [I]t is licit for the pope to [demand allegiance, and] if the infidels do not obey, they ought to be compelled by the secular arm and war may be declared against them by the pope and not by anyone else.”) See also Robert A. Williams, *THE AMERICAN INDIAN IN WESTERN LEGAL THOUGHT: THE DISCOURSES OF CONQUEST* (1992), at

<sup>94</sup> See e.g. “Bull ‘Inter caetera Divinae’ of Pope Alexander VI dividing the New Continents and granting America to Spain, May 4, 1493” in *CHURCH AND STATE THROUGH THE CENTURIES 153-57* (Sidney Z. Ehler & John B. Morrall, trans. And eds. 1967)

Wherefore, all things considered maturely and, as it becomes Catholic kings and princes . . . you have decided to subdue the said mainlands and islands, and their natives and inhabitants, . . . [w]ith the proviso, however, that these mainlands and islands found or to be found, discovered or to be discovered . . . be not actually possessed by some other Christian king or prince.

See also “*Romanus Pontifex*,” the papal bull of Pope Nicholas V (1454) (granting Portugal the exclusive right to colonize the Canary Islands and all other parts of Africa) in *CHURCH AND STATE THROUGH THE CENTURIES 153-57*; Williams *supra* note 93 at \_\_\_\_\_. See also generally Felix S.

Even after England broke away from the authority of Rome, English law still supported this “Doctrine of Discovery,”<sup>95</sup> although the validity of the doctrine was a subject of debate among early colonial settlers.<sup>96</sup> Irrespective of conflicting religious interpretations of Indian rights, practical realities shaped legal relations between the Indians and colonists.<sup>97</sup> The necessity of getting along with powerful and militarily capable Indian tribes<sup>98</sup> dictated that the settlers seek Indian consent to settle if they wished to live in peace and safety, buying lands that the Indians were willing to sell rather than displacing them by other methods. As a result, the English colonial governments acquired most of the lands by purchase from the Indians.<sup>99</sup> For all practical purposes, during this period “the Indians were treated as sovereigns possessing full ownership rights to the lands of America.”<sup>100</sup>

At the outbreak of the French and Indian War in 1754, treaty making assumed a new dimension, as each of the competing European powers sought to form alliances with the various tribes. The military importance of treaty alliances would continue throughout the Revolutionary War period as well. After the war, however, a powerful group of tribes that had sided with the British during the war confronted the founding fathers. Those tribes still maintained claims to the territory between the Appalachian Mountains and the Mississippi River. George Washington detailed his proposed policy for dealing with the Indians in a letter to James Duane, the head of the Committee of Indian Affairs of the Continental Congress.

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Cohen, *The Spanish Origin of Indian Rights in the Law of the United States*, 31 Geo. L. J. 1 (1942).

<sup>95</sup> See e.g. Calvin’s Case, 77 Eng. Rep. 377, 1378 (K.B. 1608)

All infidels are in law *perpetui inimici*, perpetual enemies (for the law presumes not that they will be converted, that being *remota potentia*, a remote possibility) for between them, as with the devils, whose subjects they be, and the Christian, there is perpetual hostility, and can be no peace; ... And upon this ground there is a diversity between a conquest of a kingdom of a Christian King, and the conquest of a kingdom of an infidel; for if a King come to a Christian kingdom by conquest, ... he may at his pleasure alter and change the laws of that kingdom: but until he doth make an alteration of those laws the ancient laws of that kingdom remain. But if a Christian King should conquer a kingdom of an infidel, and bring them under his subjection, there *ipso facto* the laws of the infidel are abrogated, for that they be not only against Christianity, but against the law of God and of nature, contained in the decalogue; and in that case, until certain laws be established amongst them, the King by himself, and such Judges as he shall appoint, shall judge them and their causes according to natural equity.

This opinion was authored by Lord Chief Justice Edward Coke who, coincidentally, wrote the charter for the Virginia Company in 1606. See Williams *supra* note 93 at \_\_\_\_.

<sup>96</sup> Compare the arguments of John Winthrop (as “for the Natives in New England they inclose noe land neither have any settled habitation nor any tame cattle to improve the land by, & soe have noe other but a naturall right to those countries.”) with those of Roger Williams (“I have knowne them make bargaine and sale amongst themselves for a small piece, or quantity of Ground [and this they do] notwithstanding a sinfull opinion amongst many the Christians have right to *Heathens* Lands.”) recounted in Cheister E. Eisinger, *THE PURITAN’S JUSTIFICATION FOR TAKING THE LAND*, 84 Essex Institute Historical Collections 135-143 (1948).

<sup>97</sup> See HANDBOOK II, p. 55.

<sup>98</sup> *Id.* Despite devastating outbreaks of disease, the Indians would continue to outnumber the European settlers for several decades.

<sup>99</sup> *Id.* The Dutch similarly opted to obtain land via consented purchase rather than more bellicose methods.

<sup>100</sup> *Id.*

[P]olicy and [economy] point very strongly to the expediency of being upon good terms with the Indians, and the propriety of purchasing their Lands in preference to attempting to drive them by force of arms out of their Country; which as we have already experienced is like driving the Wild Beast of the Forest which will return as soon as the pursuit is at an end and fall perhaps on those that are left there; when the gradual extension of our Settlements will as certainly cause the Savage as the Wolf to retire; both being beasts of prey tho' they differ in shape. In a word there is nothing to be obtained by an Indian War but the Soil they live on and this can be had by purchase at less expense [sic], and without that bloodshed, and those distresses which helpless Women and Children are made partakers of in all kinds of disputes with them.<sup>101</sup>

Although Washington's letter has been called the founding document of American Indian policy,<sup>102</sup> its clearly racist notions sit alongside the pragmatic necessity of treating with the Indians. As the newly formed United States began its inexorable march westward, the Indian lands usually were not taken by force but were instead ceded by treaty in return for, among other things, the establishment of a trust relationship,<sup>103</sup> often in specific consideration for the Indians' relinquishment of land.<sup>104</sup> It is important to note that these treaties were always entered into as government-to-government relationships between the tribes as collective political entities and the United States.<sup>105</sup> From the beginning of its political existence, therefore, the United States "recognized a measure of autonomy in the Indian bands and tribes. Treaties rested upon a concept of Indian sovereignty . . . and in turn greatly contributed to that concept."<sup>106</sup>

Treating tribes as governments was clearly more a function of pragmatism than a generally held belief that tribal governments were legitimate sovereigns, and although the Indian tribes regarded treaty obligations as sacred, racist notions of the inferiority of tribalism prompted many to question whether their provisions were binding on the United States. As Williams notes, the legal discourse of

<sup>101</sup> Letter from George Washington to James Duane (Sept. 7, 1783), in Francis Prucha, *Documents of United States Indian Policy 1-2* (2000).

<sup>102</sup> See e.g., Williams, *LOADED WEAPON*, *supra* note 68, p. 44.

<sup>103</sup> The scope of the trust relationship is multi-faceted. "Many treaties explicitly provided for protection by the United States." *HANDBOOK II*, *supra* note 7, at 65 n.38. See, e.g., Treaty with the Creeks, Aug. 7, 1790, art. 2, 7 Stat. 35, *reprinted in* Kappler, *supra* note 113, at 25 [hereinafter "Treaty with the Creeks"]; Treaty with the Kaskaskia, Aug. 13, 1803, art. 2, 7 Stat. 78, *reprinted in* Kappler, *supra* note 113, at 67 [hereinafter "Treaty with the Kaskaskia"].

Other treaties provided the means for subsistence. See, e.g., Fort Laramie Treaty, *supra* note 113 (providing for subsistence rations for the Sioux.); 1828 Treaty with the Western Cherokees, Art. 8, 7 Stat. at 313, *reprinted in* Kappler, *supra* note 113, at 290 [hereinafter "Treaty with the Western Cherokees"]; *HANDBOOK II*, *supra* note 7, at 81 ("[E]ach Head of a Cherokee family . . . who may desire to remove West, shall be given, on enrolling himself for emigration, a good Rifle, a Blanket, and a Kettle, and five pounds of Tobacco: (and to each member of his family one Blanket,) . . . a just compensation for the property he may abandon.").

<sup>104</sup> See, e.g., Treaty with the Creeks, *supra* note 103; Treaty with the Kaskaskia, *supra* note 103; Treaty with the Western Cherokees, *supra* note 103; Fort Laramie Treaty, *supra* note 113.

<sup>105</sup> See, e.g., Treaty with the Six Nations of October 22, 1784, *reprinted in* Prucha *supra* note 113, at 4; Treaty of Fort McIntosh of January 21, 1785, *reprinted in* Prucha *supra* note 113, at 5; Fort Laramie Treaty of September 17, 1851, *reprinted in* Prucha *supra* note 113, at 84 (referring to the United States and the Sioux collectively as "the aforesaid nations").

<sup>106</sup> Francis Paul Prucha, *American Indian Treaties: The History of a Political Anomaly 2* (1994).

opposition to tribal sovereignty argued that tribal Indians, “by virtue of their radical divergence from the norms and values of white society regarding use and entitlement to lands, could make no claims to possession or sovereignty over territories which they had not cultivated and which whites coveted.”<sup>107</sup> Various political factions disagreed over whether tribalism could survive contact with white civilization and whether the appropriate course of action was to make the Indians assimilate into that society or to remove them beyond the reaches of that society.<sup>108</sup> Ultimately, racist notions of tribal inferiority prevailed, and Congress passed the 1830 Removal Act.<sup>109</sup> Several tribes in the Southeast, however, already had treaties that secured their right to remain on their ancestral homeland. In response, Georgia Governor George Gilmer declared that

treaties were expedients by which ignorant, intractable, and savage people were induced without bloodshed to yield up what civilized peoples had a right to possess by virtue of that command of the Creator delivered to man upon his formation – be fruitful, multiply, and replenish the earth, and subdue it.<sup>110</sup>

The practice of purchasing land from the Indians was merely “the substitute by which humanity and expediency have imposed, in place of the sword, in arriving at the actual enjoyment of property claimed by the right of discovery, and sanctioned by the natural superiority allowed to the claims of civilized communities over those of savage tribes.”<sup>111</sup> Williams clearly demonstrates the racism inherent in the legal discourse of the Removal Period.<sup>112</sup> Despite these racist notions, however, the process of removal itself was accomplished through a series of treaties. Over the next forty years, tribal sovereignty was inherently recognized as tribes agreed to either remove to the west of the Mississippi or cede portions of their ancestral homeland in the face of advancing settlement.<sup>113</sup>

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<sup>107</sup> Williams, *supra* note 73, 243-244. Such arguments were made by several prominent individuals, including President John Quincy Adams.

The Indian right of possession itself stands, with regard to the greater part of the country, upon a questionable foundation. . . . [W]hat is the right of a huntsman to the forest of a thousand miles over which he has accidentally ranged in quest of prey? Shall the liberal bounties of Providence to the race of man be monopolized by one of ten thousand for whom they were created? Shall the exuberant bosom of the common mother, amply adequate to the nourishment of millions, be claimed exclusively by a few hundreds of her offspring? Shall the lordly savage not only disdain the virtues and enjoyments of civilization himself, but shall he control the civilization of a world?

No, generous philanthropists! Heaven has not been thus inconsistent in the works of its hands. Heaven has not thus placed at irreconcilable strife its moral laws with its physical creation.

Oration at Plymouth delivered at Plymouth Mass. December 22, 1802.

<sup>108</sup> See letter from President Jefferson to William Henry Harrison (Feb. 27, 1803) in Prucha, *supra* note \_\_, \_\_ (“[O]ur settlements will gradually circumscribe and approach the Indians, and they will in time either incorporate with us as citizens of the United States, or remove beyond the Mississippi”).

<sup>109</sup> Removal Act, ch. 148, 4 Stat. 411 (1830) (codified as amended at 25 U.S.C. § 174 (1982)).

<sup>110</sup> Quoted in PRUCHA, GREAT FATHER 196.

<sup>111</sup> *Id.*

<sup>112</sup> Williams, *Documents of Barbarism*, *supra* note 73, at 239-58.

<sup>113</sup> See e.g. Treaty of Dancing Rabbit Creek, Sept. 1830, reprinted in 2 Charles J. Kappler,

While the formal existence of the United States began at a point in time when the prevailing policy recognized tribal sovereignty through the treaty-making process, such an orientation was not permanent. In the 1870s Congress ceased making treaties with the Indians<sup>114</sup> and instead developed a policy of allotting tribal lands to individual Indians<sup>115</sup> that was characterized as a “mighty pulverizing engine”<sup>116</sup> that would destroy tribalism and force Indians to assimilate into dominant society as individuals.<sup>117</sup> Racist notions of the inferiority of tribalism were again a catalyst for policy change, but implementation of the policy required recognition of tribal sovereignty. Realization of the Allotment Act required negotiations with tribal governments, and even when eviscerating the governance structure of particular tribes, such as the Five Civilized Tribes in Oklahoma, Congress still “continued [the existence of tribes and tribal governments] in full force and effect for all purposes authorized by law.”<sup>118</sup>

If the policy objective of the Allotment Act was to improve the lives of the Indians, it was a colossal failure.<sup>119</sup> Russell Lawrence Barsh and James Youngblood Henderson describe the period between *Kagama* and the Indian Reorganization Act of 1934 as one of plenary federal control, with

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Indian Affairs, Laws and Treaties 310 (1904) (signed by Choctaw leaders at *bok chukfi ahithac*—“the little creek where the rabbits dance”—providing for the removal from the ancestral homelands in Mississippi and Alabama to land in southeastern Oklahoma); Fort Laramie Treaty, April 29, 1868, 15 Stat. 635, *reprinted in* Prucha, *supra* note 101, 109 (signed by the Sioux Nation at the conclusion of the Powder River War, establishing a reservation) [hereinafter “Fort Laramie Treaty”].

<sup>114</sup> Treaty making with the Indians was ended by Congress in 1871: “[H]ereafter no Indian nation or tribe within the territory of the United States shall be acknowledged or recognized as an independent, nation, or power with whom the United States may contract by treaty . . . .” *Abolition of Treaty Making*, 16 Stat. 544, 566 (1871), *reprinted in* Prucha, *supra* note 113, at 135.

<sup>115</sup> General Allotment Act of 1887, 24 Stat. 388 (1887). The statute is also known as the Dawes Act after Senator Henry L. Dawes of Massachusetts. While the Dawes Act represented the final, full-scale realization of the allotment policy, many treaties made with western tribes from 1865 to 1868 provided for allotment in severalty of tribal lands. *See* Robert Winston Mardock, *The Reformers and the American Indians* 212 (1971).

<sup>116</sup> In an address to Congress in 1901, President Theodore Roosevelt expressed his sense of the assimilation policy:

[T]he time has arrived when we should definitely make up our minds to recognize the Indian as an individual and not as a member of a tribe. The General Allotment Act is a mighty pulverizing engine to break up the tribal mass [acting] directly upon the family and the individual . . . .

<sup>117</sup> *See* Gavin Clarkson, *Not Because They are Brown, but Because of Ea: Why the Good Guys Lost in Rice v. Cayetano, and Why They Didn't Have to Lose*, 7 Mich J. Race & L. 318, 327 (2002)

<sup>118</sup> Five Tribes Act, Act of April 26, 1906, ch. 1876, 34 Stat. 137.

That the tribal existence and present tribal governments of the Choctaw, Chickasaw, Cherokee, Creek and Seminole tribes or nations are hereby continued in full force and effect for all purposes authorized by law, until otherwise provided by law, but the tribal council or legislature in any of said tribes or nations shall not be in session for a longer period than thirty days in any one year: Provided, That no act, ordinance, or resolution (except resolutions for adjournment) of the tribal council or legislature of any of the said tribes or nations shall be of any validity until approved by the President of the United States: Provided further, That no contract involving the payment or expenditure of any money or affecting any property belonging to any of said tribes or nations made by them or any of them or by any officer thereof, shall be of any validity until approved by the President of the United States.

<sup>119</sup> Cite to Collier 1934 report.

tribes wholly subject to Congress and the president, acting through the Bureau of Indian Affairs. No local laws or assemblies were recognized, and a special police force was established to maintain federal supremacy. Traditional leadership was deposed, prosecuted, and sometimes killed when in conflict with federal agent policy.<sup>120</sup>

By the 1930s it was clear that the United States needed to change its stance on tribal sovereignty again,<sup>121</sup> and Congress passed the Indian Reorganization Act of 1934 (IRA).<sup>122</sup> In an effort to reinforce tribal sovereignty, the legislation allowed tribes to adopt constitutions and to reestablish structures for governance. Post-IRA federal treatment of the tribes was less restrictive, allowing for the popular election of tribal leaders according to tribal laws and constitutions.<sup>123</sup> Congressional policy had completely reversed itself—tribal sovereignty was now to be encouraged rather than destroyed.

Contemporaneously with the passage of the IRA, Congress also completed a massive overhaul of the securities laws; however, those involved in crafting the Securities Act of 1933 and the Securities Exchange Act of 1934 probably never envisioned that tribal governments would ever be in the position to issue tax-exempt debt. Although this oversight does not have an impact on the tax status of tribal debt, the differential treatment of tribal securities relative to securities issued by state and local governments adversely affects tribal debt.<sup>124</sup>

Federal Indian policy would oscillate through one more cycle in the next half century before President Nixon issued a landmark statement calling for a new federal policy of “self-determination” for Indian nations.<sup>125</sup> Nineteen years after the passage of the IRA, Congress again set about destroying the tribes.<sup>126</sup> In 1953, Congress passed Public Law 83-280, a law that has been described as “a monument to congressional ambiguity and indecision.”<sup>127</sup> In Public Law 280,<sup>128</sup>

<sup>120</sup> RUSSEL LAWRENCE BARSH AND JAMES YOUNGBLOOD HENDERSONS, *THE ROAD: INDIAN TRIBES AND POLITICAL LIBERTY* 209 (1980).

<sup>121</sup> See e.g. Institute for Govt. Research, Studies in Administration, *The Problem of Indian Administration* (the “*Merriam Report*,” issued in 1928), documenting the failure of federal Indian policy during the allotment period.

<sup>122</sup> 25 U.S.C. § 461 *et seq.* (1994).

<sup>123</sup> Barsh & Henderson, *supra* note 120, at 209.

<sup>124</sup> The lack of a securities registration exemption for tribal municipal bonds imposes a liquidity premium. Preliminary research suggests that the premium ranges between 75 and 250 basis points (0.75% to 2.5%) of additional interest that must be paid by the tribal issuer. See Gavin Clarkson, *Racism in the Capital Markets*, University of Michigan Working Paper (2006). See also Clarkson testimony, *supra* note 41.

<sup>125</sup> Message from the President of the United States Transmitting Recommendations for Indian Policy, H.R.Doc. No. 91-363, 91st Cong., 2d Sess. (July 8, 1970). See also *The Indian Financing Act of 1974*, Pub. L. No. 93-262, 88 Stat. 77 (1974) (codified as 25 U.S.C. §§ 1451–1453). Perhaps the greatest of Nixon’s contributions to Indian tribal sovereignty was Public Law 638, the *Indian Self-Determination and Education Assistance Act of 1975*, Pub. L. No. 93-638 (1974) (codified in 25 U.S.C. §§ 450a–450), which expressly authorized the Secretaries of Interior and Health and Human Services to contract with and make grants to Indian tribes and other Indian organizations for the delivery of federal services.

<sup>126</sup> Barsh & Henderson, *supra* note 120, at 211.

<sup>127</sup> Act of 15 August 1953, c. 505, 67 Stat. 588-90, originally codified as 18 U.S.C. 1162 and 28 U.S.C. 1360, as amended 25 U.S.C. 1321-22; Barsh & Henderson, *supra* note 120, at 127.

<sup>128</sup> See P.L. 83-280, 6 Stat. 588 (1953), codified at 28 U.S.C. § 1360(a): “Each of the States

Congress, without tribal consent, extended state civil and criminal jurisdiction to tribal lands in six states and authorized all other states to assume such jurisdiction at their option.<sup>129</sup> This act was followed swiftly thereafter with the passage of a number of statutes liquidating individual tribes—“these acts distributed the tribes’ assets by analogy to corporate dissolution and afforded the states an opportunity to modify, merge or abolish the tribe’s government functions.”<sup>130</sup>

Federal policy once again reversed itself, and the policy of Termination was suspended in 1968 with President Nixon’s policy of “self-determination.”<sup>131</sup> By “self-determination,” President Nixon sought “to strengthen the Indian’s sense of autonomy without threatening his sense of community.”<sup>132</sup> Self-determination led to an increase in economic development activity, but access to capital remained an impediment.<sup>133</sup> President Reagan made his American Indian policy statement on January 24, 1983, stating his support for “self determination.”<sup>134</sup> In attempting to give definition to “self-determination,” he stated:

Instead of fostering and encouraging self-government, federal policies have, by and large, inhibited the political and economic development of the tribes. Excessive regulation and self-perpetuating bureaucracy have stifled local decision making, thwarted Indian control of Indian resources and promoted dependency rather than self-sufficiency.<sup>135</sup>

In 1983, President Reagan established the Presidential Commission on Indian Reservation Economies. In 1984 the Commission published its Report and Recommendations again calling for a major shift in federal Indian policy.<sup>136</sup> The Commission promulgated recommendations in the following five categories: Development Framework, Capital Formation, Business Development, Labor Markets, and Development Incentives.<sup>137</sup> Pertinent to the instant inquiry, under Capital Formation, the Commission recommended private ownership or private management of tribal enterprises; amending the Securities Act of 1933 to place

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listed . . . shall have jurisdiction over civil causes of action between Indians or to which Indians are parties which arise in the areas of Indian country listed . . . to the same extent that such State has jurisdiction over other civil causes of action, and those civil laws of such State that are of general application to private persons or private property shall have the same force and effect within such Indian country as they have elsewhere within the state . . .” (emphasis added). The Supreme Court, upon examining the legislative history of P.L. 280, found that the intent of Congress was to apply the state rules of decision in Indian Country, not to confer total jurisdiction over Indian lands. *See* Bryan v. Itasca County, *supra* note \_\_\_\_.

<sup>129</sup> Barsh & Henderson, *supra* note 120, at 128. The six mandatory states were Alaska, California, Minnesota, Nebraska, Oregon, and Wisconsin. *Id.* at 128, n. 80.

<sup>130</sup> Barsh & Henderson, *supra* note 120, at 132. Examples of this legislative activity include Act of 13 August 1954, c. 732, 68 Stat. 718 (Klamath), Act of 3 August 1956, c. 909, 70 Stat. 963 (Ottawas).

<sup>131</sup> *Id.*

<sup>132</sup> Samuel R. Cook, *What is Indian Self-Determination?*, RED INK, May 1, 1994, available at <http://faculty.smu.edu/twalker/samrcook.htm>.

<sup>133</sup> *See* HANDBOOK III *supra* note 7, §21.03

<sup>134</sup> PRESIDENTIAL COMMISSION ON INDIAN RESERVATION ECONOMIES, REPORT AND RECOMMENDATIONS TO THE PRESIDENT OF THE UNITED STATES Part I, 7 (1984).

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*, at 25.

tribes on the same footing as state and local governments; amending the Tribal Tax Status Act to provide tribes with the same tax exemptions as state and local governments; establishing an Indian Venture Capital Fund; and amending the Indian Loan Guaranty Fund and the Indian Finance Act to minimize the role of the BIA and to encourage the private sector to invest in Indian country.<sup>138</sup>

Some scholars have criticized the IRA and the notions of evaluating tribal corporations using westernized norms of corporate performance because such evaluations often highlight perceived differences between economic development in Indian Country and corporate America.<sup>139</sup> According to the Memmi typology, however, perceptions of difference that are not used to justify hostility are not racist, and thus Williams may be incorrect in assuming that capitalist assessments of tribal economies are inherently racist.<sup>140</sup> Irrespective of whether one views capitalism as good or bad, the reality is that tribal nations exist within a larger capitalist system, and any assumption that tribes cannot adapt to that system runs the risk of falling into the very discourse that Williams decries. Tribes have adapted to their environments for millennia, and the arrival of Europeans did not diminish that adaptiveness. Many tribes pride themselves on their ability to adapt: the Navajos developed a thriving weaving industry using wool from sheep brought over by Europeans; the Plains Indians incorporated European horses into their culture; and the Choctaw claim that if the Europeans had brought aluminum foil with them, Choctaws would have been cooking with it while the other tribes were still regarding it with suspicion.<sup>141</sup>

The evidence from the last century of tribal economic development indicates that tribes can and must compete within the larger capitalist environment, and given a level playing field, they can thrive. If the competitive landscape is stacked against tribes, however, those impediments can be appropriately characterized as racist if they continue to exist with little or no legitimate purpose, given that they suppress tribal economic development and curtail tribal access to capital.

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<sup>138</sup> *Id.* at 39-47.

<sup>139</sup> See e.g. Williams, *Documents of Barbarism*, 31 ARIZ. L. REV. at 266-68. Williams takes issue with the description of tribal structures contained in the PRESIDENTIAL COMMISSION ON INDIAN RESERVATION ECONOMIES, REPORT AND RECOMMENDATIONS TO THE PRESIDENT OF THE UNITED STATES (1984):

As illustrated by its derogatory nomenclature for describing tribal governments' differences ("social welfare driven"; "patronage system"; "dependent"), the Commission's discourse of tribal self-determination clearly devalues tribal enterprises operated by tribal governments according to tribal values...The Commission's point of reference for assigning negative values to contemporary tribalism's perceived self-determining vision of economic development is of course the dominant society's profit driven norms. Thus, if tribalism further declines in response to the federal government's failure to adequately fund its trust responsibility to Indian people, tribalism's own stubbornly held difference from the superior values of the dominant society will be blamed.

Williams, 31 ARIZ. L. REV. at 267-68.

<sup>140</sup> *Id.*

<sup>141</sup> Gavin Clarkson, *Reclaiming Jurisprudential Sovereignty: A Tribal Judiciary Analysis*, 50 U. KAN. L. REV 502 (2002)

## II. A BRIEF REVIEW OF PUBLIC FINANCE

### A. *The Nature of Municipal Debt*

Depending on the source of funds used to repay the debt, municipal debt can take a number of forms, generally under the umbrella of either general obligation or revenue bonds.

A **general obligation bond** can be either secured or, more commonly, unsecured and, in the latter case, the issuer will generally promise to repay principal and interest from any of the issuer's available funds.<sup>142</sup> In both secured and unsecured general obligation bonds, the general credit of the issuer is pledged.<sup>143</sup>

A **revenue bond** differs from a general obligation bond in that the debt obligation is limited in terms of recourse to a specifically identified source of revenue that is pledged to secure the debt.<sup>144</sup> The general credit of the issuer is not pledged—"[r]evenue bonds, in contrast [to general obligation bonds], pledge only the earnings from revenue-producing activities, most often the earnings from the facilities being financed."<sup>145</sup> A type of revenue bond important to the instant inquiry is the Private Activity Bond ("PAB"). With a PAB, a state or local government issues the bond for or on behalf of a private entity—"[f]or example, a sewer district would issue PABs to build a sewage plant that will then be privately managed."<sup>146</sup>

### B. *Sources of Municipal Debt*

Although bank debt and bond indentures both represent a promise to pay a specific sum of money (principal amount) at a specified date or dates in the future (maturity date) together with periodic interest at a specified rate, each type of debt has unique attributes and establishes a relationship with a different set of lenders. Additionally, given the same level of earnings, an issuer will likely be able to borrow larger amounts for longer periods by issuing bonds rather than by borrowing from a bank.

#### 1. Bank Debt

Commercial banks typically lend money to governmental borrowers as part of an ongoing business relationship. For larger amounts, a group of banks (often called a syndicate) will collectively lend money to the borrower. A borrower can usually borrow up to two times earnings from a bank or bank syndicate, and the term of a bank loan (or note) is generally three to five and sometimes up to seven years.

Bank debt can also be used as temporary financing when a borrower plans to subsequently issue more debt through a bond offering to finance a larger project. A

<sup>142</sup> See Fippinger *supra* note 20, § 1:2.2

<sup>143</sup> *Id.* See also Gelfand § 2:05

<sup>144</sup> See Fippinger § 1:2.3; Gelfand § 2:13; Recourse refers to the set of actions that the lender can take to obtain payment. In this instance, the lender can only look to the revenues specifically pledged. If those are insufficient, the lender cannot look to other assets of the issuer.

<sup>145</sup> Ellen P. Aprill, *Tribal Bonds: Indian Sovereignty and the Tax Legislative Process*, 46 ADMIN. L. REV. 333, 342 (1994).

<sup>146</sup> *Id.*

portion of the bond proceeds are then used to pay off the bank note.

## 2. Bond Indentures

Unlike bank debt that generally has a single lender holding the note, a bond indenture is a negotiable instrument that can be bought and sold in the capital markets. Thus the lenders, or bondholders, often have no direct relationship with the issuer. While issuing a bond is typically a more complex transaction than obtaining a bank loan, issuers can generally borrow larger amounts for longer terms. An issuer can borrow as much as three to four times its revenues by issuing bonds, and the payments can be stretched over ten, fifteen, or even thirty years in some cases.

Bond transactions often involve a financial intermediary, usually an investment banking firm that assists issuers in finding buyers for the bond. By marketing to a larger audience in the broader capital markets, the financial intermediary attempts to obtain the best possible interest rate and terms for the issuer, which may often be better than those available from commercial banks.

An important distinction between bank debt and bond indentures is that unlike bank loans, bonds are classified as “securities” and are therefore subject to a variety of securities laws. Note, however, that §103(c) of Tax Code treats all obligations as “bonds” even if they are bank loans, finance leases, installment purchases, or actual bond indentures.<sup>147</sup> Thus, while the debt markets differentiate substantially between bank debt and bond indentures, the Tax Code does not. For purposes of clarity, subsequent use of the term “bonds” in this article refers to bond indentures held by the capital markets and does not include the other forms of governmental debt considered to be “bonds” under §103.

### *C. Tax-Exempt Debt*

Tax-exempt debt is debt where the interest paid to the debt holder is not subject to taxation.<sup>148</sup> Because the interest is tax-free, investors are able to generate the same after-tax return with a lower interest rate as they would from a similar taxable investment that pays a higher interest rate. In addition to the availability of lower interest rates, sometimes as much as three-hundred basis points lower,<sup>149</sup> longer terms are also available in the tax-exempt market.

#### 1. The Historical Justification for States’ Tax-Free Bond Authority: Federal Subsidy of Governmental Obligations and State Sovereignty

When the first Tax Code was established in 1913, state and local bond issuances were minimal and Congress desired to avoid political opposition on the matter.<sup>150</sup> The initial rationale for the exemption has its roots in a constitutional theory of intergovernmental tax immunity.<sup>151</sup> The modern rationale for exempting

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<sup>147</sup> 26 USC § 103(c); this treatment is also the same for tribal debt under Section 7871(c) of the tax code.

<sup>148</sup> 26 USC § 103(a); see Gelfand §§ 5:01 et seq. for a thorough discussion of the history and policy rationale of tax-exempt municipal debt.

<sup>149</sup> See Handbook III, Sec 21.03. Financial measures are often expressed in terms of “basis points.” A 300 basis point difference is the same as a three percent difference.

<sup>150</sup> Gelfand § 1:13.

<sup>151</sup> See *Pollock v. Farmer’s Loan & Trust Co.*, 157 U.S. 429, 585-86 15 S.Ct. 673 (1895)

municipal bond interest from taxation is a federal policy of supporting states in their operation as governmental entities.<sup>152</sup> It has long been recognized that “[l]ong-term debt obligations are an essential source of funding for state and local governments”<sup>153</sup> and that taxing interest paid on state and local bonds “may strike at the very heart of state and local government activities.”<sup>154</sup>

The ability to issue tax-free debt is crucial not to investors, but to states, because investors are willing to accept lower interest rates in exchange for the tax-exemption.<sup>155</sup> In effect, the tax-exemption, although falling to the individual bond buyer, is a subsidy to the state treasury.<sup>156</sup> The federal government has an interest in subsidizing<sup>157</sup> state and local government operations because the subsidy both facilitates governmental operations at the local level so that the federal government does not itself have to provide these services and because it places control over what kinds of operations are undertaken in the hands of local officials, thus removing these operations from the federal government.<sup>158</sup>

This latter rationale – local control – is related to a notion of state sovereignty. Indeed, the doctrine of state sovereignty stems from the basic constitutional structure that endows the federal government with a limited set of enumerated powers.<sup>159</sup> Further, the Supreme Court has long recognized the power of the federal government to tax states as a threat to state sovereignty.<sup>160</sup> To the extent

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(holding that a tax on interest income derived from a state bond, whether imposed by the Federal government or by another state, was unconstitutional as an indirect tax on the state because of the burden it imposed on the state’s ability to issue the bond.) The Court reasoned that, although the tax was imposed on the bond-holder, the tax was considered to be “on” the state because a portion of the burden, or the “incidence” of the tax, would be borne by the state in an increased interest rate or fewer buyers. The Court’s rationale was not limited to bonds in particular, but was based on a theory of intergovernmental tax immunity under which it was unconstitutional to tax any state-derived income, whether from bonds, employment or leases. *See also* *South Carolina v. Baker*, 485 U.S. 505, 516-17, 108 S.Ct. 1355 (1988) (discussing intergovernmental tax immunity at time *Pollock* was decided). This rationale was later repudiated by the Supreme Court in *Graves v. New York ex rel. O’Keefe*, 306 U.S. 466, 480 (1939) (“The theory ... that a tax on income is legally or economically a tax on its source is no longer tenable.”) *See also* *South Carolina v. Baker*, 485 U.S. at 523-24 (holding that interest paid on state bonds is not immune from Federal taxation under the constitutional doctrine of intergovernmental tax immunity).

<sup>152</sup> As noted *infra*, the exemption from federal taxation for interest paid on state-issued debt is also related to a notion of state sovereignty. This notion of state sovereignty roughly parallels the doctrine of Tribal sovereignty, and thus provides analogous support for equal tax-free bond authority.

<sup>153</sup> *South Carolina v. Baker*, 485 U.S. at 531 (O’Connor, J., dissenting).

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* at 185.

<sup>156</sup> *Id.*

<sup>157</sup> The amount of the subsidy is a matter of empirical analysis beyond the scope of this Article; suffice it to say, however, the subsidy enjoyed by states is significant. The Supreme Court has recognized that without the exemption, states would have to increase the interest they pay on bonds by between 28% and 35% over what they are able to pay with the subsidy. Because bond revenue is so important to states, “governmental operations will be hindered severely if the cost of capital rises by one third.” *South Carolina v. Baker*, 485 U.S. at 531 (O’Connor, J., dissenting).

<sup>158</sup> *See* Klein *supra* note 155.

<sup>159</sup> *See* Lawrence Tribe, *American Constitutional Law* 381 (2d. ed. 1988). *See also*, Tenth Amendment.

<sup>160</sup> *See* *South Carolina v. Baker*, 485 U.S. at 533 (O’Connor, J., dissenting) (citing Chief Justice Marshall from *McCulloch v. Maryland*, 4 Wheat. 316, 431 (1819), “the power to tax involves the

that states are sovereigns, the federal policy of exempting interest paid on state bonds issued to finance and effectuate state policy from federal taxation is a recognition and affirmation of that sovereignty.<sup>161</sup>

## 2. Uses for Tax-Exempt Debt

States issue tax-exempt bonds not only to finance a core set of traditional governmental purposes such as building schools, roads, and sewers but also to finance airports, docks, commuting facilities, utilities, mortgages, public golf courses, and even state lottery buildings and horse race tracks.<sup>162</sup> Changes to the Tax Code in 1986 sought to restrict this practice by placing limitations on private activity bonds.<sup>163</sup> After these changes, some municipalities began locating other sources of revenue to remain within the permissible tax-exempt bounds while still supporting private use projects. Discussing this phenomenon in the case of professional sports stadiums, Prof. Frank Mayer wrote:

The practical result of the 1986 Act was to change the method of debt repayment. Municipal officials and stadium owners structured their debt repayment so that revenue streams from the actual stadium accounted for less than 10% of the total repayment, while the public was responsible for the remaining 90%. This financing plan forced the federal government to recognize a stadium construction project as a public facility and consequently permit tax-exempt bond financing. In order to reach the 90% public funding level, municipal governments have employed techniques including increasing the sales tax, tourist tax, sin taxes, and implementing a tax on lottery proceeds.<sup>164</sup>

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power to destroy.”)

<sup>161</sup> See Williams *supra* note 27, at 358 (“Principles of federalism, together with practical financial considerations, dictate that the capability of state and local governments to raise and use revenue should be facilitated and enhanced whenever possible in order that they may better serve the needs of their people.”)

<sup>162</sup> See William A. Klein, Joseph Bankman, Daniel Shaviro, *FEDERAL INCOME TAXATION* 186 (13<sup>th</sup> ed. 2003).

<sup>163</sup> IRS Revenue Ruling 03-116 explains the section 141 definition of private activity bonds as follows:

Section 141 provides, in part, that a bond is a private activity bond if the bond is issued as part of an issue that meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2). The private business use test is met if more than 10 percent of the proceeds of an issue are to be used for any private business use. The private security or payment test is met if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of an issue is directly or indirectly (1) secured by an interest in property used or to be used for a private business use, (2) secured by an interest in payments in respect of such property, or (3) to be derived from payments, whether or not to the issuer, in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(e) provides, in part, that the term “qualified bond” includes any private activity bond that (1) is a qualified 501(c)(3) bond; (2) meets the applicable requirements of § 146; and (3) meets the applicable requirements of each subsection of § 147. While § 103(a) of the 1986 Tax Code exempts from gross income interest on state and local bonds, such exemption is not extended to private activity bonds which are not also qualified bonds. I.R.C. § 103(b)(1).

<sup>164</sup> Frank A. Mayer, III, *Stadium Financing: Where We Are, How We Got Here, and Where We*

The more popular approach, at least concerning hotels and convention centers, involves management agreements between a private entity and a municipality arranging for the private business to run the facility. This practice accelerated after 1997 when the permissible length of these management contracts was extended from five to fifteen years, initiating a “boom in publicly financed hotels.”<sup>165</sup> Hotel projects, involving tax-exempt issuances of hundreds of millions of dollars, have commenced in a number of municipalities, including the following:

- The Austin City Council approved the authorization of up to \$275 million of tax-exempt bonds to finance an 800-room hotel near the city’s newly expanded convention center.<sup>166</sup>
- Baltimore issued \$305 million to build a Hilton convention hotel in downtown Baltimore.<sup>167</sup>
- The Chicago Metropolitan Pier and Exposition Authority issued \$133 million of tax-exempt hotel revenue bonds for a Hyatt Hotel<sup>168</sup>
- The City of Omaha Convention Hotel Corporation sold \$103.5 million of tax-exempt bonds for a 450-room hotel to be managed by Hilton Hotel.<sup>169</sup>
- The Denver Convention Center Hotel Authority issued \$349 million in revenue bonds to build a 1,100-room hotel managed by the Hyatt Corporation.<sup>170</sup>
- The South Carolina Jobs-Economic Development Authority issued \$63.4 million in bonds to fund construction of a 404-room hotel to be operated by Radisson Hotels International Corporation.<sup>171</sup>
- The Indianapolis Local Public Improvement Bond Bank issued \$18.2 million in tax-exempt bonds to help fund a 230-room luxury Hilton hotel.<sup>172</sup>
- Overland Park, Kansas, issued \$87 million in bonds to build a 412-room, full-service convention center hotel operated under a 15-year contract by Sheraton Operating Corporation.<sup>173</sup>
- The city of West Palm Beach, Florida, issued \$55 million in tax-exempt

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*Are Going*, 12 VILL. SPORTS & ENT. L.J. 195, 210-11 (2005).

<sup>165</sup> Mary Wisniewski, *Cities Play Hotel Game: Face Choices on Independence, Risk*, BOND BUYER, August 30, 2001, at 1.

<sup>166</sup> Elizabeth Albanese, *Austin City Council Approves Bond Authorization for Hotel Financing*, BOND BUYER, March 14, 2001, at 5.

<sup>167</sup> Andrew Ackerman, *Baltimore Convention Hotel Plan Gets Second Nod From City Council*, BOND BUYER, August 17, 2005, at 5.

<sup>168</sup> Karen Pierog, *Chicago hotel revenue to back exposition authority bond sale*, BOND BUYER, February 26, 1996, at 1.

<sup>169</sup> Elizabeth Carvlin, *Deal in Focus: City-Backed Omaha Hotel Granted Rare Insurance Coverage*, BOND BUYER, April 10, 2002, at 34.

<sup>170</sup> Elizabeth Albanese, *Deal in Focus: Denver Selling \$349 Million for Convention Center Hotel*, BOND BUYER, June 17, 2003, at 27.

<sup>171</sup> Christine Albano, *Big Entrance: Hotel Deals Set Off Frenzied Buying, Earn High Yields*, BOND BUYER, June 6, 2001, at 1.

<sup>172</sup> Elizabeth Carvlin, *Indianapolis Bond Bank Plans \$28M For Hotel, With Moral Obligation*, BOND BUYER, May 4, 2004, at 4.

<sup>173</sup> Christine Albano, *High-Yield Focus: Kansas Hotel Deal’s Revised Structure Eases Buy-Side Concerns*, BOND BUYER, December 20, 2000, at 7.

revenue bonds for a parking structure for CityPlace, a \$550 million mixed-used development downtown.<sup>174</sup>

- The Virginia Economic Development Review Issued \$10 million in tax exempt bonds to renovate the Stonewall Jackson Hotel, which contains 124 deluxe guest rooms.<sup>175</sup>
- The District of Columbia Council approved a measure authorizing the redevelopment of the Washington Convention Center site, which could eventually lead to up to \$1.3 billion in tax-exempt bond issuances.<sup>176</sup>

Private activity bonds are still widely used as an important tool for state and local economic development.<sup>177</sup> A similar practice involves the issuance of tax-exempt bonds to build hotels in economically depressed areas eligible by their empowerment zone status. Such was the situation in the following instances:

- Little Rock, Arkansas, voters approved the issuance of \$19 million in tax-exempt empowerment zone revenue bonds to renovate the Little Rock Hilton.<sup>178</sup>
- San Antonio issued \$130 million of tax-exempt empowerment zone bonds to finance a new Hyatt Corporation 1,000-room convention center hotel.<sup>179</sup>
- The St. Louis Industrial Development Authority issued \$98 million of tax-exempt federal empowerment zone bonds to partially fund the construction of a convention center hotel.<sup>180</sup>

Tax-exempt bonds have not only been used to build hotels and convention centers but also to finance horse tracks owned by counties or municipalities.

- In 1987, Polk County, Iowa officials issued \$40 million in tax-exempt bonds to build the Prairie Meadows Horse Racing Track.<sup>181</sup>
- Retama Park outside of San Antonio was financed with \$75 million in tax-exempt debt financing.<sup>182</sup> Retama Development, the nonprofit organization set to by the city to construct and equip the racetrack in 1997, subsequently issued \$93.9 million in refunding bonds.<sup>183</sup>
- The Grand Prairie Sports Facilities Development Corporation refinanced “one of the most successful horse racing tracks in the state” in part by

<sup>174</sup> Shelly Sigo, *West Palm Beach, Fla., Still Has All-Stars in Its Eyes*, BOND BUYER, July 20, 2001, at 37.

<sup>175</sup> Matthew Vadum, *VIRGINIAL: Hotel Gets Facelift*, BOND BUYER, October 27, 2005, at 35.

<sup>176</sup> Matthew, Vadum, *Old D.C. Convention Center Site Gets Go-Ahead for Redevelopment*, BOND BUYER, June 8, 2005, at 4.

<sup>177</sup> Aprill, *supra* note \_\_, at 342.

<sup>178</sup> Elizabeth Albanese, *Little Rock Voters Approve Hotel Bond Issue*, BOND BUYER, July 11, 2002, at 3.

<sup>179</sup> Elizabeth Albanese, *San Antonio Deal for Hyatt Hotel Empowered With Tax-Exemption*, BOND BUYER, April 26, 2005, at 1.

<sup>180</sup> Yvette Shields, *St. Louis' Hotel Financing Deal Wins Investment-Grade Rating*, BOND BUYER, November 15, 2000, at 3.

<sup>181</sup> *Will County Bet on Racetrack Bonds?* HOUSTON BUSINESS JOURNAL, August 24, 1992, at 1.

<sup>182</sup> Janin Friend, *Lone Star racetrack is set to issue debt, but some in industry say deal is risky*, BOND BUYER, July 7, 1994, at 1.

<sup>183</sup> Emily Newman, *Tax Enforcement: IRS: Texas Development Corp.'s \$171M of Debt May Be Taxable*, BOND BUYER, January 12, 2005, at 5.

issuing \$15.2 million of tax-exempt debt.<sup>184</sup>

### 3. Additional Restrictions on Tribal Tax-Exempt Debt

While the federal policy of exempting interest paid on state bonds from federal taxation is a recognition and affirmation of that state's sovereignty, a similar recognition and affirmation of sovereignty unfortunately does not extend to Indian tribes to the same degree as state and local governments because tribes face two additional restrictions that do not apply to their counterparts. In the first instance Indian tribes cannot issue PABs similar to those issued by state and local governments.<sup>185</sup> As mentioned previously, an additional restriction limits tribal tax-exempt bonding authority to those projects where "substantially all" of the borrowed proceeds "are to be used in the exercise of any essential governmental function."<sup>186</sup> As the tax-base of a tribe is usually insufficient for a tribe to issue general obligation bonds<sup>187</sup> and since the revenue from a revenue bond is usually linked to the project being financed,<sup>188</sup> this additional restriction to "customary" governmental activity places tribes at a tremendous disadvantage relative to the capital markets and is inequitable when compared to other forms of municipal debt.

## III. LEGISLATIVE AND REGULATORY MANEUVERING OVER TRIBAL TAX STATUS

### A. *The Tax Status of Indian Tribes before the 1982 Tribal Tax Act*

The Tribal Tax Status Act was the culmination of a huge effort by tribes and their advocates on Capitol Hill to achieve a measure of equality with states in the Tax Code.<sup>189</sup> Before its passage, and despite the fact the federal government had for more than 150 years recognized Indian tribes as sovereign governmental entities with obligations and responsibilities to their constituents equal to those of states, Indian tribes occupied a strange and internally inconsistent niche within federal tax laws. Prior to 1982, IRS Revenue Rulings rather than statutes governed the taxation of tribes.<sup>190</sup> Under Revenue Ruling 67-284, the IRS reasoned that because tribes occupy a space in government roughly analogous to states, income

<sup>184</sup> Darrell Preston, *Deal in Focus: Texas Town Cleans Up at the Track With Recent Refunding*, BOND BUYER, March 30, 1999, at 22.

<sup>185</sup> See Williams *supra* note 27, at 382; Aprill *supra* note 27 at 335; see also Hyatt, Israel, *et al*, *supra* note 24, p. 19 ("State and local governments often issue tax-exempt private activity bonds for the benefit of nonprofit corporations, or to finance mortgage loans for first-time low- and moderate-income home buyers, or to finance low- and moderate-income residential rental property. Private activity bonds are also issued for airports, docks, and wharves, solid waste facilities, sewage facilities, and certain other facilities."). Under current law, Indian tribes are barred from issuing private activity bonds for anything other than a tribal manufacturing facility. 26 USC §§ 7871(c)(2)-(c)(3).

<sup>186</sup> 26 USC § 7871(c)(1). "Substantially all" is not defined in the statute but is believed to mean at least 95% of the proceeds. See Hyatt, Israel, *et al*, *supra* note 24, p. 18

<sup>187</sup> See Williams *supra* note 27, at 385 ("few Indian communities enjoy the thriving economic environment necessary to sustain a stable tax base").

<sup>188</sup> See Aprill *supra* note 27, at 342.

<sup>189</sup> See generally, *id.* (detailing testimony by Indians and comments by various Congressmen in considering the 1982 Act).

<sup>190</sup> See Aprill *supra* note 27 at 335; Williams *supra* note 27, at 358.

of a tribal government like that going to a state, is exempt from federal taxation.<sup>191</sup> The IRS failed to pursue the same logic, however, when it denied tribes the ability to issue tax-free debt. Revenue Ruling 68-231 erroneously reasoned that since the powers of a tribe are delegated to it by the federal government<sup>192</sup> rather than a state (in that case, Washington), it cannot be considered a “state” for purposes of I.R.C. section 103’s exemption from federal taxation for interest paid on state and municipal debt.<sup>193</sup> Lingering uncertainty because of inconsistencies in how the IRS made its rulings on the tax status of tribes led Congress to take up consideration of a comprehensive Indian tax law.

The 1982 act was not the first serious attempt at comprehensive Indian tax legislation, as a bill that would have granted tribes a similar tax status to states was introduced in 1975.<sup>194</sup> This legislation proposed equal treatment in the areas of federal excise taxes, charitable donation deductions, and deductibility of property taxes. An important provision would have authorized tribes to issue tax-exempt bonds on nearly the same grounds as states under I.R.C. section 103.<sup>195</sup> The House Ways and Means Committee reported H.R. 8989 favorably,<sup>196</sup> but the legislation was not considered by the full House.<sup>197</sup> No further action was taken<sup>198</sup> until Congress’s consideration of a senate bill<sup>199</sup> that would eventually become the 1982 Tribal Tax Status Act.

#### *B. The Passage of the 1982 Tribal Tax Status Act*

Senate Bill 1298 was introduced by five senators<sup>200</sup> for the purpose of

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<sup>191</sup>Rev. Rul. 67-284. Williams notes that the IRS made this ruling despite the absence of any express Congressional authority for such an exemption, a true anomaly in tax law. Williams *supra* note 27, at 359 n.113. This ruling, then indicates the strength of the premise that Indian tribes are in fact political entities within the United States with duties and obligations owed to their constituents.

<sup>192</sup> See Handbook III, *supra* note , § 5.A.1.

<sup>193</sup> Rev. Rul. 68-231. As Williams notes, critics have argued that the IRS has adopted inconsistent positions in these two revenue rulings. Williams *supra* note 27, at 360, n.116. Other revenue rulings also failed to provide equal treatment for tribes, in denying a tax deduction for a charitable donation to the Zuni Pueblo under I.R.C. section 2055 (Rev. Rul. 74-179), and denying an exemption from federal excise taxes under I.R.C. section 4224 for the sale of an automobile to an Indian Tribe (Rev. Rul. 58-610).

<sup>194</sup> H. R. 8989, 94<sup>th</sup> Cong., 1<sup>st</sup> Sess. (1975).

<sup>195</sup> Under section 103, States can issue two types of tax-free debt: general obligation bonds that are backed by the “full faith and credit” of the governmental entity issuing the debt; and revenue bonds, which are backed by the earnings of specific project being financed. Revenue bonds include Private Activity Bonds (PABs) or what were previously known as Industrial Development Bonds (IDBs). PABs are issued by the state or municipality but the financed facilities are used by or for the benefit of a private entity. PABs are a common tool in economic development projects by states. *See, e.g.*, Aprill *supra* note 27, at 341-43 (discussing state bonding authority under section 103). The 1975 Legislation would have assured “nearly” identical bonding authority for tribes as compared to states, but not “completely” identical authority because it is clear that tribes would have had a more limited ability to issue tax exempt bonds for commercial or industrial activity. This legislation also would have limited the issuance of tax free debt to support governmental functions. *See id.*

<sup>196</sup> H.R. Rep. No. 1693, 94<sup>th</sup> Cong., 2d Sess. 1 (1976).

<sup>197</sup> See Williams *supra* note 27, at 364-65; Aprill *supra* note 27, at 344.

<sup>198</sup> Aprill, *supra* note 27, at 344.

<sup>199</sup> S. 1298, 97<sup>th</sup> Cong., 1<sup>st</sup> Sess. (1982) [hereinafter S. 1298].

<sup>200</sup> The bill was sponsored by Malcolm Wallop (R-Wy), Bill Bradley (D-NJ), Mark O. Hatfield (R-Ore.), Bob Packwood (R-Ore.), and Max Baucus (D-Mont). S. 1298.

equalizing the treatment of states and tribes in a number of areas of the Tax Code, including tax-free bonding authority. Senate Bill 1298 would have enabled tribes to issue tax-exempt debt obligations to finance their governmental activities under section 103 of the Internal Revenue Code.<sup>201</sup> Tribes would have achieved equal treatment with states by virtue of the legislation's reference to section 103, which defines states' tax-free bonding authority. At the time this authority was quite broad and included the authority to issue controversial industrial development bonds for a variety of projects. Tribes were also given such authority in the senate bill as long as the trade or business financed by the issuance occurred on the tribe's reservation.<sup>202</sup> The Senate Finance Committee reported the bill favorably and recommended passage without amendment.<sup>203</sup> The Senate incorporated this bill into House Bill 5470, the Periodic Payments Settlement Act, which the House passed without the tribal tax legislation piece.<sup>204</sup> Representative Sam Gibbons (D-Fl), in particular, objected to the tribal tax provisions, a setback which sent the bill to a conference committee to which Representative Gibbons was named.<sup>205</sup>

While the stated purpose of the introduced legislation was to eliminate the perception of differences between tribal governments and state or local governments,<sup>206</sup> the ultimate legislation that emerged from the House-Senate Conference Committee emphasized rather than eliminated those differences. Those fundamental changes in the legislation are detailed in the rest of this section. Part V will make the argument that, under the Memmi typology, those changes were based on racist notions and that their continued existence in the Tax Code is a perpetuation of that racism.

The first major change in the legislation was to specifically prevent tribes from issuing any tax-free PABs. Tribes retained the ability to issue general obligation bonds, traditionally used for funding ventures such as school construction.<sup>207</sup> Tribal governments, however, "lack[ed] a diversified economy as well as the broad, stable tax base" necessary to issue general obligation bonds.<sup>208</sup> Thus, tribes were "given bonding authority they were unable to use and denied bonding authority they would have welcomed."<sup>209</sup> Prior to the emergence of the conference bill, every version of the Tribal Tax Status Act had included specific authority for tribes to engage in at least some limited form of tax-exempt private activity bond financing.<sup>210</sup> None of the witnesses or members of the Senate or House in printed hearings, committee reports, or debate had ever raised an objection to allowing tribes to enjoy the same status as state and local governments relative to private activity bonds.<sup>211</sup> Moreover, the Treasury Department had specifically endorsed all

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<sup>201</sup> S. 1298. *See also* Williams *supra* note 27 at 363.

<sup>202</sup> S. 1298; Williams *supra* note 27 at 363.

<sup>203</sup> S. Rep. No. 646, 97<sup>th</sup> Cong., 2d Sess. at 8-17 (1982).

<sup>204</sup> *See id.*

<sup>205</sup> Many of Rep. Gibbons' actions will be analyzed in Part V.

<sup>206</sup> Cite to preamble of S.1298

<sup>207</sup> Aprill, *supra* note 27, at 348.

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*

<sup>210</sup> Cite to each prior version of the bill. *See also* Williams *supra* note 27, at 368 n.149

<sup>211</sup> Williams, *supra* note 27, at 368 n.149

of the earlier versions of the Tribal Tax Status Act, including the provisions Indian tribes used to issue tax-exempt PABs, stating “that tribal governments should be treated for federal tax purposes in the same manner as state and local governments.”<sup>212</sup> Treasury supported this legislation, despite its broader efforts to generally curtail and limit tax-exempt PABs,<sup>213</sup> arguing that entities that “are similarly situated should be treated alike for tax purposes if the law is to be applied fairly and equitably.”<sup>214</sup> Given the limited tribal tax base<sup>215</sup> available for general obligation bonds,<sup>216</sup> the ability to issue revenue bonds<sup>217</sup> was one of the most important provisions sought by tribal governments.

The Conference Committee Report, however, stated quite clearly that “tribal governments are not permitted to issue private activity bonds ([such as] industrial development bonds [or] mortgage subsidy bonds),”<sup>218</sup> thus ensuring that tribal bonds could not be used for economic development projects that might generate profits for private actors.<sup>219</sup>

If the elimination of any chance of PABs issuance were not bad enough, the Conference Committee Report also added the additional requirement on tribes’ authority to issue tax-free debt. Tribes were authorized to issue tax-exempt bonds “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.”<sup>220</sup> The essential governmental function language may seem innocuous enough, since under section 103, states are granted tax-free bond authority as a tool with which to perform their general governmental functions.<sup>221</sup> The “essential governmental function” element of the legislation, however, was unmistakably an “additional requirement”<sup>222</sup> that was not imposed on states. Thus, by virtue of the 1982 Tribal Tax Status Act, Indian tribes only receive tax-free treatment of their debt obligations under a narrower set of projects than states. The open question after passage of the 1982 act was, what was an “essential governmental function?”

### C. Initial Implementation of the 1982 Tribal Tax Status Act

The Conference Committee Report accompanying the 1982 act offered little explanation of the essential governmental function requirement but did indicate that tribes were granted tax-free bond authority to undertake only a core set of government projects, and that Congress was primarily concerned with preventing private actors from benefiting from the tax subsidy. Because the essential governmental function test also circumscribes tribes’ general ability to issue tax-free debt obligations under section 103; however, the issue becomes whether tribes

<sup>212</sup> Cite to statement of William McKee at 58

<sup>213</sup> Williams *supra* note 27, at 368 n.149

<sup>214</sup> Cite to statement of William McKee at 58

<sup>215</sup> Cite to tribal economic data

<sup>216</sup> See Part III.A *supra*

<sup>217</sup> *Id.*

<sup>218</sup> H.R. Conf. Rep. No. 97-984, 97<sup>th</sup> Cong., 2d Sess. 16-17 (1982) *reprinted in* 1982 U.S.C.C.A.N. 4598, 4602 (emphasis added).

<sup>219</sup> Cite to specific language in the conference report. See Aprill, *supra* note \_\_\_\_, p. 346.

<sup>220</sup> Pub. L. No 97-473.

<sup>221</sup> See *supra* Part I.

<sup>222</sup> I.R.C. § 7871(c) is entitled: “Additional requirements for tax exempt bonds.”

themselves (where no private entity benefits) can engage in a broad range of activities – such as construction of hotel resorts and public-use golf courses – that are not necessarily within a set of core government-provided services.

In the wake of the passage of the 1982 act, the IRS was charged with determining the scope of tribes' tax-free bonding authority. As Professor Ellen Aprill points out, however, defining the term "essential governmental function" is no easy task.<sup>223</sup> Several Supreme Court cases illustrate the ambiguity of this term and its ultimate "unworkability."<sup>224</sup> Early cases upheld federal taxation of income paid to the trustees of the Boston Elevated Railway Company because operating a street railway was proprietary rather than governmental,<sup>225</sup> yet struck down a tax imposed on the salary of a New York water system engineer because operating a water system *had developed into* a governmental function.<sup>226</sup> Later cases effectively eliminated the term from Congress's arsenal by declaring that "what might have been viewed in an earlier day as an improvident or even dangerous extension of state activities may today be deemed indispensable,"<sup>227</sup> and that the distinction had become "too entangled in expediency to serve as a dependable legal criterion."<sup>228</sup>

To address this issue, tribes obtained legal representation to advise the Treasury Department that the essential governmental function requirement should be construed broadly in light of the overriding purpose of the 1982 Tribal Tax Act to "provide relief to Indians."<sup>229</sup> The strategy worked, and Indians were given tax-free bond authority under the regulations not only for any activity that would be exempt if undertaken by a state or local government but also any activity for which Indian tribes receive funding from the Bureau of Indian Affairs under either the Snyder Act<sup>230</sup> or the Indian Self-Determination Act.<sup>231</sup> Because both acts fund a broad range of activities,<sup>232</sup> tribal bond authority was also relatively broad. For

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<sup>223</sup> See Aprill *supra* note 27 at 348.

<sup>224</sup> *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 543 (1985) (holding that the distinction between essential and nonessential governmental functions is unworkable and that such a distinction cannot be given any "principled content.")

<sup>225</sup> *Helvering v. Powers*, 293 U.S. 214, 227 (1934).

<sup>226</sup> *Brush v. Commissioner*, 300 U.S. 352, 370 (1937). This case emphasizes that the notion of what is an essential governmental function is not a fixed set of public projects. Indeed, just as the Supreme Court recognized that many projects can become more "essential" to governments over time, some governments may deem certain projects more essential than other governments. This is especially true in the case of Indian tribes, many of which are located in areas that simply do not enjoy the benefits of a diverse private sector. Thus, while for most citizens of this country, their entertainment is provided by the private sector, for Indians, their only option is to turn to the Tribal government for entertainment outlets. Arguably, tribes should be granted a freer hand in the use of tax-free debt obligations because of the lack of private sector services; instead, as this article demonstrates, they now have one hand tied behind their back in utilizing tax-free debt.

<sup>227</sup> *Garcia*, 469 U.S. at 543.

<sup>228</sup> *New York v. United States*, 326 U.S. 572, 580 (1946) (plurality opinion) (Frankfurter, J., announcing the judgment of the Court).

<sup>229</sup> Aprill at 351 (citing Letter & Memorandum from Fried, Frank, Harris, Shriver & Kampelman to Hugo Santora, Legislative Analysis Officer, Internal Revenue Service 1 (June 28, 1983)).

<sup>230</sup> 25 U.S.C. § 13 (1988).

<sup>231</sup> 25 U.S.C. §§ 450 *et seq.* (1988).

<sup>232</sup> See Aprill *supra* note 1 at 351.

instance, tribes could issue tax-free debt obligations to finance “general support” activities and “industrial assistance and advancement.”<sup>233</sup>

Despite the broad language, very few bond issuances were actually made under the 1982 act and the arguably generous (for tribes)<sup>234</sup> regulations. Aprill reports that only seven tribal issuances had occurred by the time Congress revisited the legislation in January of 1988.<sup>235</sup> Of these projects, only one was a traditional governmental function on the reservation; six were “off-reservation leveraged buy-outs.”<sup>236</sup> For example, one of the reported issuances helped the Salt River Pima-Maricopa (AZ) Indians purchase a cement factory to be used primarily as an income-generating investment to help pay for other tribal services.<sup>237</sup>

Despite the small number of reported transactions, this relatively broad bonding authority turned out to be short-lived as both the language of the statute and the agency’s approach to enforcing it would soon become severely restrictive on tribes.

#### *D. Congress Slams the Door --The 1987 Amendments to the Tribal Tax Status Act*

Five years after the 1982 act, Representative Gibbons sponsored a measure in the Omnibus Budget Reconciliation Act of 1987<sup>238</sup> to restrict the use of tribal bonds by clarifying the essential governmental function requirement.<sup>239</sup> The House Committee Report explained that in light of “recent reports of Indian tribal governments issuing tax-exempt bonds for what are substantively interests in commercial and industrial enterprises,” the “committee believes [that] it is appropriate to reiterate the scope of bond authority granted to Indian tribal governments.”<sup>240</sup> The clarification measure thus limited essential functions for purposes of tribal tax-free bond authority to those functions that are “customarily performed by State and local governments with general taxing powers.”<sup>241</sup>

<sup>233</sup> *Id.* at 351 (citing 25 U.S.C. § 13).

<sup>234</sup> See Aprill at 357

<sup>235</sup> *Id.* However, because of the differential treatment of tribal debt under the federal securities laws, many tribal bonds have been issued as private placements and thus may not have been reported by the Bond Buyer or other publicly available media. See generally Gavin Clarkson, Racism in the Capital Markets, *supra* note 124.

<sup>236</sup> *Id.* at 358. A “leveraged buy-out” is a purchase of a company by investors who borrow a substantial portion of the purchase price. This arrangement is useful to tribes who often do not have the tax base to support large issuances of general obligation bonds. *Id.* at 348.

<sup>237</sup> Joan Pryde, *Two Bond Issues Sold By Tribes May Face Review by Congress*, BOND BUYER, June 9, 1987.

<sup>238</sup> Pub. L. No. 100-203 § 10632 (a), 101 Stat.1330 (1987).

<sup>239</sup> House Report No. 100-391 1139, 100<sup>th</sup> Cong. (1987).

<sup>240</sup> H. R. No. 100-391, 1139, 100<sup>th</sup> Cong. (1987). One of the reports of commercial-based Indian bond activity was a clearly anti-Indian article in appearing in *Forbes* magazine entitled “Smoke Signals.” Matthew Schifrin, *Smoke Signals*, FORBES, June 15, 1987, at 42 (available on Lexis). The Schifrin article incorrectly describes Tribal bond authority as exempt from “the shared restrictions placed by last year’s tax reform act on the volumes of underwriting that municipal bodies around the country can engage in.” The characterization is false because the volume limitations applied to private activity bonds, an authority specifically denied to tribes by the 1982 Act. See Aprill *supra* note 27 at 359 (discussing the inaccuracy of the *Forbes* article). Despite its inaccuracies, the *Forbes* article appears to have “sounded an alarm for Congress,” and Gibbons in particular, that clarifying legislation was needed to shut down Tribal bond activity. *Id.* at 360.

<sup>241</sup> Pub. L. No.100-203 § 10632; codified at 7871(e) (emphasis added).

In addition, on September 10, 1987, Gibbons wrote a letter to Treasury Secretary James Baker imploring the department to investigate leveraged buy-outs by tribes.<sup>242</sup> He also noted that such projects are a “far cry from schools, streets and sewers,”<sup>243</sup> recalling the one line of explanation in the 1982 legislative history explaining the essential governmental function requirement.<sup>244</sup>

Although it had passed the house, Gibbons’ amendment was not included in the Senate version of the 1987 Budget Act, and it was opposed by many in the Senate as too draconian. Twenty-two senators wrote a letter to the Chairman of the Senate Finance Committee, to oppose the measure in Conference.<sup>245</sup> Their concern was that the amendment would stifle tribes’ efforts to “decrease tribal unemployment, alleviate poverty, preserve natural or cultural resources of the tribe or contribute to tribal economic activity.”<sup>246</sup> As an alternative, this group proposed targeting potential abuses more precisely by eliminating bonding authority for projects that produced only passive income from investments in real estate or other off-reservation ventures.<sup>247</sup> This less restrictive alternative would have allowed tribes to utilize tax-free debt obligations much in the same manner as states. Unfortunately, Rep. Gibbons was able to secure an appointment to the Conference Committee and was able to push through his stifling amendment with only one relatively insignificant carve-out for tribes.<sup>248</sup>

While Aprill describes the amendment as a “measure to tighten the tribal bond measures by limiting essential governmental functions to those customarily financed with exempt bonds by state and local governments,”<sup>249</sup> the specific statutory language had the potential for a much more restrictive interpretation: limiting tribal tax-exempt bond authority to those projects typically financed with general tax revenue, a narrower set of projects than those typically financed through tax-free debt obligations.<sup>250</sup>

*E. The IRS Nails the Door Shut -- Aggressive Enforcement of the Essential Governmental Function Requirement*

In the wake of the 1987 amendment, one issue facing tribes seeking to utilize tax free debt obligations is that Congress has provided little guidance, other than

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<sup>242</sup> Aprill at 361.

<sup>243</sup> *Id.*

<sup>244</sup> H.R. Conf. Rep. No. 97-984, at 16-17.

<sup>245</sup> John J. Doran, *22 Senators Urge Bentsen to Oppose Legislation to Curb Indian Bond Power*, BOND BUYER, Dec. 14, 1987, at 6.)

<sup>246</sup> *Id.*

<sup>247</sup> *Id.*

<sup>248</sup> *Id.*; Pub. L. No. 100-203 §10632(b). Tribes were permitted to issue industrial development bonds if the proceeds were used for Tribally-owned manufacturing facilities on tribal lands and that employed Tribal members. Pub. L. No. 100-203 §10632(b), codified at I.R.C. § 7871(c)(3)(D). Aprill notes that the employment restriction is “particularly onerous.” Aprill, *supra* note 27 at 362 n.175. The requirement is that the aggregate amount of bonds outstanding at the end of each year may not exceed twenty times the wages paid to tribal members. Thus, if a Tribe issues \$200 million in debt, it must pay tribal members \$10 million that year, effectively reducing the amount available for investment. I.R.C. § 7871(c)(3)(D).

<sup>249</sup> Aprill p. \_\_\_\_

<sup>250</sup> Indeed, as discussed *infra*, this distinction will surface in an IRS field service audit, much to the detriment of tribes.

the limiting language in the 1987 Conference Report, as to what is and what is not an essential governmental function customarily performed by states.<sup>251</sup> As noted above, the uncertainty engendered by these terms provides little guidance for regulated entities, in this case, Indian tribes,<sup>252</sup> and much leeway to regulators, in this case, the IRS. As it turns out, the IRS has taken its cue from Representative Gibbons and has recently decided to aggressively enforce an extremely narrow interpretation of the essential governmental function requirement. *Indian Country Today* noted that “Indian country as a whole is becoming more familiar” with the IRS’s enforcement efforts because of its inclusion in tribal tax-free bond financing in its investigative audits.<sup>253</sup> For the years 2002, 2003, and 2004, state and local governments issued an average of 14,038 tax exempt bonds.<sup>254</sup> Over the same period, tribal government annually issued an average of 5 tax-exempt bonds.<sup>255</sup> For the years 2002, 2003, and 2004, the Tax Exempt Bonds Office closed an average of 363 audits each year.<sup>256</sup> Assuming that an exam takes two years to complete,<sup>257</sup> this time period results in approximately 1.29% of all state and local tax-exempt issues being audited; however, not all of those obligations are considered bonds by the capital markets.<sup>258</sup>

Based on an initial survey of bond lawyers, approximately 20% of all bonds under the Tax Code are bond indentures that are held by the capital markets. Thus, the approximate lifetime audit hazard rate for municipal bond indentures is approximately one-half of one percent. In contrast, there was general belief among professionals in the field of tribal debt issuances that the percent of tribal bond issues audited is substantially greater. In a March 2005 *Bond Buyer* article, Charles

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<sup>251</sup> A recent letter sent by Eric Solomon, the Treasury Department’s acting deputy assistant secretary for tax policy, seems to have only added to the uncertainty. See Alison L. McConnell, *Enforcement: Treasury Letter Leaves Lawyers Debating Tribal Bonds Issue*, BOND BUYER, January 19, 2006. While some have interpreted the letter as validating the IRS’s current enforcement stance, others argued that “Solomon’s juxtaposition of “essential governmental function” with “customary” activities of state and local governments...sustained tribes’ arguments for financing commercial facilities with tax-exempt bonds.” *Id.*

<sup>252</sup> *Indian Country Today* has noted the possibility that “tribes could be penalized for not complying with a dodgy definition.” Rebecca L. Adamson, *The Taxman Cometh*, INDIAN COUNTRY TODAY, January 14, 2003.

<sup>253</sup> *Id.*

<sup>254</sup> See Thomson Financial Data Extract, *supra* note 42.

<sup>255</sup> *Id.*

<sup>256</sup> TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *Statistical Portrayal of the Tax Exempt Bond Office’s Enforcement Activities From Fiscal Year 2002 through Fiscal Year 2004* (September 2005), available at, <http://www.treas.gov/tigta/auditreports/2005reports/200510186fr.pdf>.

<sup>257</sup> The length of a bond audit is variable and recent reports detail means to shorten the audit cycle. See ADVISORY COMMITTEE ON TAX EXEMPT AND GOVERNMENT ENTITIES, *AUDIT CYCLE TIME AND COMMUNICATIONS: EMPLOYEE PLANS AND TAX EXEMPT BONDS* (June 9, 2004), available at, [http://www.irs.gov/pub/irs-tege/act\\_rpt3\\_part4.pdf](http://www.irs.gov/pub/irs-tege/act_rpt3_part4.pdf). For the purposes of this article, two years is believed to be representative of the average cycle time. Even if the average cycle time is more or less than two years, the underlying point of disparate between state and local and tribal tax-exempt issuances remains true.

<sup>258</sup> Section 103(c) of Tax Code treats all obligations as “bonds” even if they are bank loans, finance leases, or installment purchases, or in fact bond indentures. This treatment is the same for tribal debt under Section 7871(c) of the tax code. Thus, while the debt markets differentiate substantially between bank debt and bond indentures, the Tax Code does not.

Anderson, field operations manager for the IRS tax-exempt bond office, stated the intention to conduct “a dozen or more examinations of tribal bond issues within the next year or so.”<sup>259</sup> In September 2005, Charles Anderson stated that twelve tribal tax-exempt bonds, six tribal conduit bonds, and six direct tribal issues, are currently being challenged by the IRS.<sup>260</sup> Christie Jacobs of the office of Indian Tribal Governments at the IRS stated during February 2006 that 8 to 10 tribal tax-exempt issues were currently under audit.<sup>261</sup> Dale White, general counsel for the Mohegan Tribe, states that of the tribe’s two bond issuances, one has been audited. In a January 12, 2006 Memorandum, several Dorsey & Whitney tax attorneys expressed the following opinion regarding the IRS’ enforcement practices:

We believe that, if the Service were forced to defend its position before a court, the tribes should prevail on both of these issues [direct tribal issues and conduit issues]. Our concern is that, by initiating numerous audits against individual tribal issuers, the Service is (a) taking on the tribes one by one, (b) without the tribes being able to coordinate their analysis, research and arguments, (c) in a situation where it is very difficult to get the issues before a court for review.<sup>262</sup>

This disparate treatment does not show signs of waning. Rick Saskal, of *The Bond Buyer*, recently wrote, “The Internal Revenue Service has been stepping up audit reviews of the tax-exempt status of tribal bond issues.”<sup>263</sup>

To empirically determine the audit hazard rate for tribal bonds, in April, 2006, the author and his tribal finance research team from the University of Michigan met with officials and researchers from the Tax-Exempt Bond division of the Internal Revenue Service to discuss the issue of tribal tax-exempt bonds and develop a research plan to examine whether or not tribal governments were subject to a disproportionate audit rate for their bonds. For this work, the IRS examined a particular form that is filed by all governments, including tribal governments, whenever they issue a debt obligation of any kind. When governments enter into debt obligations, if the interest paid to the lender is tax-exempt, then a form 8038 needs to be filed with the IRS. If the obligation is for an amount greater than \$100,000, then a form 8038G is filed, otherwise a form 8038GC is filed.

In collaboration with the University of Michigan researchers, IRS researchers determined that 88 tribes had filed one or more informational returns between January 1, 2002 and December 31, 2005 (note that this data reflects direct tribal issues only; conduit issues are not included in these figures):

Form 8038G	136
Form 8038GC	169

<sup>259</sup> Emily Newman, *IRS Looking for Evidence of Arbitrage Abuse*, BOND BUYER, March 16, 2005.

<sup>260</sup> See Alison L. McConnell, *IRS’ Anderson Says Attorneys At Fault for Tribal Bond Confusion*, BOND BUYER, September 22, 2005. See also discussion of tribal conduit bonds, *supra*, note 348.

<sup>261</sup> Figure taken from phone conversation with Christie Jacobs on February 14, 2006.

<sup>262</sup> Mark A. Jarboe, LynDee Wells, Thomas D. Vander Molen, Mary J. Streitz of Dorsey & Whitney, *Memorandum to Tribal Clients Concerning Tribal Tax-Exempt Financings* (January 12, 2006).

<sup>263</sup> Rick Saskal, *Panel: Open Tax-Exempt Market More to Tribes*, THE BOND BUYER, September 26, 2005, at 4.

On either form, Line 20 allows the tribe to check a box to indicate whether the obligation is a lease or installment purchase. The data was then broken down into the following:

Form 8038GC	
Leases or Installment Sales	105
Bank Loans or Bond Indentures	64
Form 8038G	
Leases or Installment Sales	46
Bank Loans or Bond Indentures	90

The following was also determined, however, in the course of the research:

- While some tribal debt examinations were initiated from referrals, the majority of tribal debt examination cases were initiated by the IRS through its normal case selection process.
- Of the 305 filings (issues), slightly less than 1% are being examined
- Of the 88 tribes that filed, approximately 3% have bonds under examination.
- The total dollar amount of debt issued during this time period is around \$700,000,000.

Although a greater level of detail would of course be desirable, the IRS is limited in its ability to disclose based on rather strict confidentiality requirements. Thus, the remaining data analysis and conclusions in this section do not necessarily reflect the views of the IRS.

A preliminary survey of tribal bond lawyers indicates that for every tribal bond indenture requiring an 8038G filing, four to five bank loans are also closed that require an 8038G filing. Thus, for the 90 form 8038G filings from 2002 through 2005, assuming that 20% were for bond indentures, 18 tribal bonds indentures were issued between 2002 and 2005, or an average of 4.5 per year. Municipal bond indentures of less than \$100,000 rarely exist, if at all, so the 8038GC filings have been excluded. If those are not excluded, the average number of bonds is six per year; however, data from Thompson Financial on tribal bonds issued between 2002 and 2005 indicates that there were 20 bonds issued.

Based on information from tribes and tribal bond attorneys for tribes that are currently being audited, all of the audits for debt obligations issued between 2002 and 2005 were for bond indentures, none was for bank debt.

Using the IRS data, the three audits for bonds indentures issued between 2002 and 2005 represent 16.6% of all tribal bond indentures issued during that same period, more than thirty-two times the hazard rate for state and local bonds during the same period.<sup>264</sup> Using the Thompson data generates a tribal hazard rate of 15%, or twenty-nine times the hazard rate for state and local governments. In either case, the audit hazard rate for tribal bonds in only their first four years after issuance is substantially more than an order of magnitude greater than the lifetime hazard rate

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<sup>264</sup> This disparity can be measured even more precisely if the IRS can determine the total number of 8038G and GC forms that were filed between 2002 and 2005. Such a number would provide the total number of bonds, which can be compared with the Thompson Financial data for capital market bond indentures.

for state and local government bonds.

The instances of tribal audits appears even more disturbing when one considers the fact that tribal tax-exempt issues make up only one-tenth of one percent of the tax-exempt bond market.<sup>265</sup> For the years 2002-2004, state and local governments issued on average \$363.6 billion of tax-exempt debt<sup>266</sup> while tribal governments issued on average only \$202 million of tax-exempt debt.<sup>267</sup> The focus of IRS resources on issuances making up merely .1% of the total market by itself raises a presumption of improper IRS practices toward tribes.

*F. Is the IRS Blocking a Fire Escape? Uncertainty Regarding Tribal Conduit Financing*

Constricted by the discriminatory essential governmental function requirement, some tribes have chosen to finance projects such as hotels on a taxable basis; however, several tribes attempted to use an alternative tax-exempt mechanism referred to as a “conduit financing.”<sup>268</sup> In a conduit financing the tax-exempt security is actually issued by a local government agency (referred to as the conduit issuer) to finance a project for a third party (referred to as the conduit borrower). The security for this type of issue either is the credit of the conduit borrower or pledged revenues from the project itself rather than the credit of the conduit issuer. Such securities are not general obligations of the conduit issuer because the conduit borrower is liable for generating the pledged revenues. Since the conduit issuer is not subject to the “essential governmental function” test, the conduit mechanism should enable a tribe to finance projects with tax-exempt bonds that it might otherwise have to finance on a taxable basis.<sup>269</sup>

Additionally, conduit financing is an established form of public finance typically utilized by 501(c)(3) (non-profit) organizations, such as charity hospitals. Conduit financing has also won the endorsement of the Tax Court. In *Fairfax County Economic Development Authority v. Commissioner*,<sup>270</sup> the Tax Court held that the development authority was the real issuer of industrial development bonds used to build a facility, a portion of which would be leased to the United States Government Printing Office.<sup>271</sup> It reached this conclusion despite the fact that the federal government was the obligor of the bonds because the credit of the government as a lessor of the retail space backed the bonds.<sup>272</sup> The Tax Court reasoned that form governs substance in section 103 cases and held that the development authority be respected as the issuer of the bonds, even though the

<sup>265</sup> See Spreadsheet and letter from Lisett Rodriguez of Thomson Financial on May 12, 2006.

<sup>266</sup> *Id.* For 2002, 2003, and 2004, state and local governments issued \$355,545.5 billion, \$378,961 billion, and \$356,504.8 billion dollars of tax-exempt debt respectively. *Id.*

<sup>267</sup> *Id.* For 2002, 2003, and 2004 tribal governments issued \$194.4 million, \$233.3 million, and \$178.4 million dollars of tax-exempt debt respectively. *Id.*

<sup>268</sup> Merrill Lynch has suggested that the use of conduit financing directly “stems from inequities in the tax code,” Merrill Lynch Municipal Credit Research, “Indian Gaming Bond Pricing Update,” May 24, 2004.

<sup>269</sup> See Hyatt, Israel, *et al*, *supra* note 24, p. 21.

<sup>270</sup> 77 T.C. 546 (1981).

<sup>271</sup> *Id.* at 546-49.

<sup>272</sup> *Id.*

federal government was the real obligor.<sup>273</sup>

Despite the criticism of the IRS's aggressive approach in the 2002 FSA, however, the service is also taking a hostile enforcement stance against conduit financing by tribes as well.<sup>274</sup> The IRS has now challenged 100% of the tribal attempts to issue conduit bonds.<sup>275</sup>

#### IV. APPLICATION OF THE MEMMI TYPOLOGY

The legislative and regulatory activities against tribal bonding authority are clearly harmful and discriminatory, but can they still be fairly labeled as racist under the Memmi typology, with its four moments of racism?

1. An insistence on difference, whether real or imaginary
2. The imposition of a negative valuation upon those seen as differing
3. Generalizing that difference to an entire group that is then deprecated in turn.
4. Justifying hostility, aggression, or privilege based on that generalized difference.<sup>276</sup>

Thus, in order to sustain the charge of racism in the Tax Code, it is necessary to elucidate how the ultimate legislation was shaped by perceptions of difference that were generalized to a broader group and how the negative connotations of the perceived difference were used to justify the hostility or aggression against the broader group, either during the legislative process or in subsequent IRS enforcement actions. When analyzed within Memmi's typology, the actions of Representative Gibbons and the ultimate acquiescence of his legislative colleagues provide just such evidence. Details of the IRS enforcement actions provide further evidence.

##### *A. Applying the Memmi Typology to Rep. Gibbons*

###### 1. The Strategy of Difference

Williams has carefully documented the discourse of difference regarding Indians from the moment of first contact between Europeans and the indigenous inhabitants of North America,<sup>277</sup> so by the time a 33 year-old Sam Gibbons was first elected to the Florida legislature in 1953, Indian tribes were already well

<sup>273</sup> *Id.*

<sup>274</sup> See Theberge *supra* note 340, at 186.

<sup>275</sup> See Alison L. McConnell, *IRS' Anderson Says Attorneys At Fault for Tribal Bond Confusion*, BOND BUYER, September 22, 2005; Susanna Duff Barnett, *\$145.5M Cabazon Deal Under Scrutiny IRS Steps Up Probes of Indian Tribes*, BOND BUYER, August 6, 2004 (discussing IRS examination of \$145.5 million in tax-exempt bonds issued by the California Statewide Communities Development Authority on behalf of Cabazon's East Valley Tourist Development Authority); Shelly Sigo, *IRS Queries Fla. Tribe's Use of Bonds Casino-Hotel May Be Private Activity*, BOND BUYER, May 7, 2004 (discussing IRS examination of \$345 million in tax-exempt bonds issued by Capital Trust Agency on behalf of Seminole Tribe in 2002); Emily Newman, *IRS to Audit Seminole Tribe of Florida's \$124 Million of Tax-Exempt Bonds*, BOND BUYER, February 3, 2005 (discussing IRS examination of \$124 million in tax-exempt bonds issued by Capital Trust Agency on behalf of Seminole Tribe in 2003 and 2004); Rich Saskal, *IRS Takes Closer Look at Calif. Tribal Deal's Tax-Exempt Status*, BOND BUYER, August 30, 2005 (discussing IRS examination of \$51 million in tax-exempt bonds issued on behalf of Morongo Band of Mission Indians in 2004 for water and wastewater system improvements).

<sup>276</sup> Memmi, *RACISM*, *supra* note \_\_\_\_ at xvii-xviii.

<sup>277</sup> See Williams *supra* note 73, at 262-265; see generally Williams, *LOADED WEAPON*, *supra* note 68.

entrenched as different in the minds of many Florida politicians. Having grown up in 1920s and 1930s, Gibbons was likely influenced by the dominant view of Indians as anachronistic savages, wholly separate from civilized society.<sup>278</sup> Having attended all-white institutions for his undergraduate and legal education,<sup>279</sup> Gibbons was likely influenced by the rhetoric and practice of segregation. As a practicing lawyer, Gibbons might possibly have taken note of the racist discourse used to describe Indian tribes in the 1950s, including language used by the Supreme Court in *Tee-Hit-Ton Indians vs. United States*:

Every American schoolboy knows that the savage tribes of this continent were deprived of their ancestral ranges by force and that, even when the Indians ceded millions of acres by treaty in return for blankets, food and trinkets, it was not a sale but the conquerors' will that deprived them of their land.<sup>280</sup>

Although they were likely a source of campfire stories during Gibbons' schoolboy years, the Florida Seminoles were recognized as a sovereign tribe in 1957, and were thus governed by separate laws and regulations than other Floridians, such as Title 25 of the U.S. Code and Title 25 of the Code of Federal Regulations. As Williams notes, even if Gibbons was not overtly racist, there is a substantial body of empirical and theoretical research that "demonstrates that the cognitive biases that can give rise to prejudice and racist attitudes can operate in an unconscious, automatic, uncontrolled fashion."<sup>281</sup>

However, Gibbons was probably not alone, given that after centuries of overt and covert hostility by the United States, the weakened economic state of the Florida Seminoles probably did not resemble a sovereign government in the minds of most Floridians either. Even once they were acknowledged as a sovereign entity, the likely perception was that the tribal government did not provide services but instead relied on the federal government. At a minimum, the "savage" existence of the Florida Seminoles during his childhood and continuing through his election to Congress would certainly have entrenched the tribe as being different in Gibbons' mind. The imputation of a negative value to that difference, however, was evident in one instance in a long-running dispute between the Florida Seminole tribe and Representative Gibbons. By all accounts, Gibbons harbored a lingering hostility toward Indian interests stemming from his involvement in a tribal land deal in which trust land was reportedly exploited for private benefit in the construction of a 1400-seat bingo hall and a cigarette shop.<sup>282</sup>

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<sup>278</sup> See e.g. Robert F. Berkhofer, *THE WHITE MAN'S INDIAN* (1979); Williams, *LOADED WEAPON*, *supra* note 68.

<sup>279</sup> The University of Florida did not admit black students until 1958. See <http://www.ufl.edu/history/1948.html>.

<sup>280</sup> *Tee-Hit-Ton Indians vs. United States*, 348 U.S. 272, 289-90 (1955). Note that this opinion came the year after *Brown's* repudiation of such racist discourse as applied to those of African-Americans.

<sup>281</sup> Williams, *LOADED WEAPON*, *supra* note 68, at 164.

<sup>282</sup> See Aprill *supra* note 27 at 346 (citing John McCormack, *New Riches Grow from Old Burial Ground*, *MIAMI HERALD*, May 31, 1983, at 6A).

## 2. The Assignment of Negative Values to Difference

During excavation for a city parking garage in Tampa in 1979, bones of 140 Seminole Indians were unearthed on the site.<sup>283</sup> The discovery threatened to bring the parking garage project to a halt, but the Seminoles proposed to move their ancestors' remains to new land as a solution if they could obtain the necessary space.<sup>284</sup> Tampa and Florida officials accepted the offer, and federal officials, including Gibbons, helped the tribe obtain new trust land for this purpose. The Seminoles did, in fact, rebury the bones and erect a museum above the tomb.<sup>285</sup> They also, however, constructed a cigarette shop and large bingo parlor, both financed by a private partnership that in exchange received 47% of the proceeds from the two operations.<sup>286</sup>

Just as municipal entities such as fire departments had long generated operational revenues from bingo,<sup>287</sup> commercial gaming on Indian reservations in the United States began modestly as a response to a fire that destroyed two trailers on the Oneida Indian reservation in Verona, New York in 1975. The reservation had neither a fire department nor fire-fighting equipment, and two Oneidas perished in the blaze. To prevent such tragedies in the future, reported a tribal representative, the Oneidas decided "to raise money for [their] own fire department... the way all fire departments raise money: through bingo."<sup>288</sup>

The Oneidas launched a bingo game in an oversized trailer, offering prizes in excess of the limits permitted by New York law.<sup>289</sup> The Oneidas maintained that because they were an Indian nation, they were not bound by state bingo regulations. Tribe members claimed that their right of sovereignty entitled them to run their own game and to offer a jackpot large enough to draw non-Indians—and their money—to a place they otherwise might never visit.

The Seminoles began their own high-stakes bingo game in Hollywood, Florida, in 1979. The Seminole tribe contracted with a non-Indian organization to build and manage its bingo hall. The agreement called for the managers to receive 45% of the profits after repayment of a \$1 million construction loan. The enterprise was a success, and the Seminoles repaid the loan in less than six months.<sup>290</sup> The Seminoles also fought the state in the courts when Florida authorities tried to close the Seminoles' bingo hall in 1981. The tribe argued that Florida did not have the authority to prohibit gaming on the Seminole reservation. Ultimately, the Fifth

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<sup>283</sup> *Id.*

<sup>284</sup> *Id.*

<sup>285</sup> *Id.*

<sup>286</sup> *Id.*

<sup>287</sup> Dennis McAuliffe, Jr., "Casinos Deal Indians a Winning Hand," *Washington Post*, March 5, 1996: A1. Other accounts suggest that Florida was the birthplace of Indian gaming. See William T. Bisset, "Tribal-State Gaming Compacts: The Constitutionality of the Indian Gaming Regulatory Act," 21 *HASTINGS CONST. L.Q.* 71, 72 (1993).

<sup>288</sup> McAuliffe, p. A1

<sup>289</sup> See Gavin Clarkson and James Sebenius, *Leveraging Tribal Sovereignty for Economic Opportunity: A Strategic Negotiations Perspective*, presented at the Harvard Native Issues Symposium, December 2003.

<sup>290</sup> *Id.*

Circuit agreed,<sup>291</sup> relying upon the Supreme Court's holding in *Bryan v. Itasca County*<sup>292</sup> that under P.L. 280,<sup>293</sup> if a state regulates but does not prohibit an activity, it may not prohibit that same activity in Indian Country. Thus the Seminoles secured the right to run their bingo game and pay out unrestricted prizes.

Although the Seminoles had always indicated to officials that they planned to use their new land for economic development projects, Gibbons and other officials were "incensed" and accused the tribe of "hiding its true intentions about the use of the land."<sup>294</sup> With its negative view of commercial activity by the Seminoles, and with Gibbons' support, Florida unsuccessfully sued to halt the activities of the tribe by challenging the trust status of the land in Tampa.<sup>295</sup> By all available accounts Representative Gibbons held a lasting hostility toward Indian interests as a result of the Seminole burial ground episode.<sup>296</sup>

### 3. Generalization

Representative Gibbons' reported hostility is not limited to the tribe in his district, however, as he held a particular suspicion that Indians anywhere could not be trusted and would use any opportunity to finance undesirable gambling operations.<sup>297</sup> In his letter to Treasury Secretary James Baker, he insinuated that the tribes were not really acting as governments and used the leveraged buyouts as exemplars, all the while ignoring that the revenue generated by those projects went to fund essential governmental functions.<sup>298</sup> If not the first, Gibbons was certainly one of the early congressional leaders to put forward the generalized notion that any commercial or revenue generating activity was somehow less "governmental" if it was conducted by a tribe, as that would make it a "far cry from schools, streets and sewers."<sup>299</sup> This generalization clearly privileged, to the detriment of the tribes, the commercial elements of many state and local governmental enterprises that are funded with tax-exempt debt.<sup>300</sup>

Various accounts have confirmed that Gibbons' grudge prompted him to join the Tribal Tax Act Conference for the purpose of denying tribes meaningful bond

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<sup>291</sup> See *Seminole Tribe of Florida v. Butterworth*, 658 F.2d 310 (5<sup>th</sup> Cir. 1981) (applying the Supreme Court's decision in *Bryan v. Itasca County* to Florida's bingo law, holding that Florida had no regulatory jurisdiction over the tribe, and therefore could not prohibit Indian gaming).

<sup>292</sup> 426 U.S. 373 (1976)

<sup>293</sup> See discussion of P.L. 280 *supra*.

<sup>294</sup> See Aprill *supra* note 27 at 346 (citing John McCormack, *New Riches Grow from Old Burial Ground*, MIAMI HERALD, May 31, 1983, at 6A).

<sup>295</sup> *Florida, Dep't of Business Regulation v. United States Dep't of Interior*, 768 F.2d 1248 (11<sup>th</sup> Cir. Fla. 1985)

<sup>296</sup> See Aprill *supra* note 27, at 346 n.77 (writing that "[w]hether or not true, (Gibbons' reputation) has come to be accepted and believed.")

<sup>297</sup> *Id.* See also Williams *supra* note 27, at 368 n.146.

<sup>298</sup> Aprill at 361.

<sup>299</sup> *Id.*

<sup>300</sup> This hostility towards tribal governments that engaged in any sort of commercial or revenue generating activity would only get worse as Indian gaming revenues increased. See Gavin Clarkson and James Sebenius, *Leveraging Tribal Sovereignty for Economic Opportunity: A Strategic Negotiations Perspective*, Working Paper. See also discussion of ERISA, note 368 *infra*.

authority.<sup>301</sup> Author Emma Gross wrote in 1989 that Gibbons' "disillusionment with his Indian constituency is supposed to be the reason that he currently opposes Indian interests."<sup>302</sup> Although Representative Gibbons developed an accepted reputation as hostile toward tribal interests in his district, his animosity extended to tribal interests everywhere.

#### 4. Justification of Hostility

Gibbon's belief that Indians in general are not trustworthy issuers of public debt coupled with his powerful position in the House led to the adverse outcomes in 1982 and again in 1987. Is it possible that Gibbons' justifications for hostile treatment of tribal tax-exempt debt were based on something other than a negative perception of difference between tribal governments and other state and local governments? Gibbons did have a reputation as an active opponent of PABs. He has been described in various reports as "a longtime opponent of tax-exempt, private-activity bonds,"<sup>303</sup> as having "maintained a steady opposition to private-activity bonds,"<sup>304</sup> and as "traditionally ... an antagonist toward public finance."<sup>305</sup> Thus, it might be reasonable to argue that Gibbons opposed broad tribal bonding authority not necessarily because he was hostile to Indian interest, but, rather, because he was hostile toward broad tax-based public finance authority in general.

This argument fails for two reasons. First, Gibbons not only increased his opposition to tax-exempt bond authority in the case of the Tribal Tax Status Act, but also supported "tax-exempt financing when it would benefit his (non-Indian) constituents."<sup>306</sup> Gibbons' effort to create a new category of tax-exempt bonds to finance the construction and improvement of space centers in Florida<sup>307</sup> indicates that he was perfectly willing to support broad-based bonding authority when Indian tribes were not the beneficiaries. Second, the record is clear that the limitations on tribal bond authority *not applicable to states or municipalities* have been enacted "largely at Gibbons' urging."<sup>308</sup> Thus, the efforts of Representative Gibbons, albeit with the consent of the other conferees, imposed a drastic limitation on tribes that, to this day, gives them access only to a narrow sector of the tax-free capital market. It is undeniable that Gibbons largely created what today remains a blatant discrepancy between tribes' and states' bonding authority.

The timing of Gibbons' legislative efforts as well as his 1987 letter to Treasury

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<sup>301</sup> Aprill writes that "[t]he experience prepared Representative Gibbons to object to the tribal bond provision in the Senate bill." *Id.* at 346. The Bond Buyer reported that Gibbons "wage[d] a campaign in 1987 against bonds issued by Indian tribes." Joan Pryde, *Meet Sam Gibbons: Rostenkowski's stand-in is not an admirer of private-activity bonds*, The Bond Buyer, August 13, 1993.

<sup>302</sup> Emma R. Gross, CONTEMPORARY FEDERAL POLICY TOWARD AMERICAN INDIANS 84 (1989).

<sup>303</sup> Craig Ferris, *Foe of private activity debt to leave Congress*, BOND BUYER, March 05, 1996.

<sup>304</sup> Joan Pryde, *Meet Sam Gibbons: Rostenkowski's stand-in is not an admirer of private-activity bonds*, BOND BUYER, August 13, 1993.

<sup>305</sup> *Id.*

<sup>306</sup> *Id.*

<sup>307</sup> *Id.*

<sup>308</sup> *Id.*

Secretary James Baker complaining about tribal tax-exempt bonds<sup>309</sup> is also suspicious. In 1986, the Supreme Court denied *certiorari* in the litigation regarding the Seminole's land-into-trust application for the Tampa property,<sup>310</sup> so having lost in the effort to fight tribal economic development in his own district, Gibbons expanded his efforts in 1987 to thwart economic development throughout Indian County.

The results of Gibbon's hostility is self-evident. Because of the additional restrictions imposed on Indian tribes that do not apply to state and local governments, tribes cannot issue PABs similar to those issued by state and local governments,<sup>311</sup> nor can they issue tax-exempt debt unless "substantially all" of the borrowed proceeds pass the ill-defined essential governmental function test.

*B. Applying the Memmi Typology to IRS Enforcement Activity*

Through its enforcement activities, the IRS continues to propagate this racism in the Tax Code. Although the legislative restrictions resulted from demonstrably racist motives, the IRS has chosen to pursue the most restrictive interpretation possible in its enforcement, exacerbating the racist effect. In fairness to the IRS, however, it does not have the freedom to ignore or fail to enforce a racist statute. On the other hand, the enforcement actions of the IRS suggest that it is further exacerbating the racist impact of §7871 by pursuing an extremely narrow, and arguably incorrect, interpretation of the statute.

1. The Strategy of Difference

Although tribes are not states, the direct congressional intent of the Tribal Tax Status Act was to treat tribes like states. In the eyes of the IRS, however, if a tribe is involved with a commercial activity, it is somehow less of a government, even if the revenues from that activity fund basic governmental functions. The IRS does not seem to take the same position with states that are involved with commercial activities, such as state-run liquor stores in New Hampshire, state operated hotels resorts, and convention centers, or public golf courses. Thus the perception of difference between tribal commercial activity and state commercial activity is a false difference. Nonetheless, the IRS continues to insist that such a difference is meaningful relative to tribes. For example, Charles Anderson of the IRS's tax-exempt bond enforcement program, speaking about the Pauite golf course, recently stated:

However, anyone other than the law firm issuing an unqualified opinion and maybe being sued by a tribe would concede that a hypothetical golf complex - having multiple prestige courses in a resort town with a website advertising

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<sup>309</sup> Aprill at 361.

<sup>310</sup> 475 U.S. 1011 (1986).

<sup>311</sup> See Williams *supra* note 27, at 382; Aprill *supra* note 27, at 335; see also Hyatt, Israel, *et al*, *supra* note 24, p. 19 ("State and local governments often issue tax-exempt private activity bonds for the benefit of nonprofit corporations, or to finance mortgage loans for first-time low- and moderate-income home buyers, or to finance low- and moderate-income residential rental property. Private activity bonds are also issued for airports, docks, and wharves, solid waste facilities, sewage facilities, and certain other facilities."); Under current law, Indian tribes are barred from issuing private activity bonds for anything other than a tribal manufacturing facility. 26 USC §§ 7871(c)(2)-(c)(3).

planned hotels and casinos, and who has marketed the courses in partnership with travel promoters - is essentially commercial in nature.<sup>312</sup>

Anderson continued:

If there are more golf holes than tribal members it is probably commercial and intended solely for tourists. If no tribal members work there and they all collect a dividend, it is probably commercial. I don't think Congress ever anticipated several dozen people getting six-figure checks due to a resort financed by tax-exempt bonds.<sup>313</sup>

Standing in stark contrast, the Maryland Board of Public Works, in 1996, approved the sale of \$26 million in tax-exempt revenue bonds as partial funding for a golf resort in western Maryland.<sup>314</sup> State officials indicated that the state-owned golf resort would include a 220-room hotel and a public golf course, designed by Jack Nicklaus, on the grounds of Rocky Gap State Park and is a long-planned economic development project for Alleghany County.<sup>315</sup>

## 2. The Assignment of Negative Values to Difference

Anderson's words strongly suggest an imposition of a negative value on tribal commercial activities, as does an August 9, 2006 advance notice of proposed rulemaking from the IRS. In that notice, the IRS suggests that tribal bonds would only be tax exempt if 1) Numerous State and local governments with general taxing powers have been conducting the activity and financing it with tax-exempt governmental bonds; 2) State and local governments with general taxing powers have been conducting the activity and financing it with tax-exempt governmental bonds for many years, and 3) the activity is not a commercial or industrial activity, even if states and local governments routinely engage in such activities for commercial purposes. Clearly the IRS has a strongly negative view of tribal commercial activity relative to state and local governmental commercial activity.

## 3. Generalization

Since the Tax code applies to all tribes equally, the generalization of the negative view of tribal commercial activity is automatic, and tribes throughout the United States have been victims of this aggressive enforcement of a racist statute, resulting in a demonstrably stifling effect on tribes' tax-free bonding authority. The communications from some at the IRS seem to give the impression that the IRS believes that all tribes are wealthy tribes engaged in gaming and are thus not entitled to tax-exempt treatment, since they would merely be receiving a subsidy for commercial activity. This generalization of tribal economic status is particularly harmful to poorer tribes, as these restrictions on the scope of what can be financed with tax-exempt debt in particular deny poor tribes the opportunity to address their glaring infrastructure and economic development needs. Tribes with

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<sup>312</sup> Alison L. McConnell, *Bond Lawyers: IRS Out of Order on Tribal Financings*, BOND BUYER, November 3, 2005, at 4.

<sup>313</sup> *Id.*

<sup>314</sup> Amy B. Resnich, *Golf Resort debt proposal passed by Maryland works board*, BOND BUYER, May 2, 1996, at 11.

<sup>315</sup> *Id.*

substantial natural resources or significant gaming operations have the option of financing certain activities on a taxable basis even if, absent a restrictive Tax Code, they would be able to finance those activities on a tax-exempt basis. As mentioned earlier, however, poorer tribes do not have that luxury, and upwards of \$50 billion in annual capital needs go unmet in Indian Country, in part because the debt service required to finance the projects to meet those needs is too expensive at taxable rates.

The IRS's generalization of the restrictive provision of §7871 to all tribes has also meant a substantially higher audit risk for tribal bonds, as tribal governments are also victims of a demonstrably disproportionate number of IRS enforcement actions. Less than 1% of the tax-exempt municipal offerings are audited by the IRS each year, but direct tribal tax-exempt issuances are 30 times more likely to be audited within four years of issue,<sup>316</sup> and 100% of tribal conduit issuances have been or are currently being challenged by the IRS.<sup>317</sup> In all of these cases, the tribes financed activities that had previously been financed by state and local governments without any challenge from the IRS.

In the specific instance of the Paiute golf course audit, in arguing that that the golf course was not “intended to meet the recreational needs of [the] Tribe or that it is anything other than a commercial enterprise of [the] Tribe,”<sup>318</sup> the IRS is apparently making another generalization that Indians do not play golf, and if they do play golf, they only play at courses that would never attract a non-Indian golfer.

#### 4. Justification of Hostility

In a recently issued Technical Advice Memorandum (“TAM”),<sup>319</sup> the IRS justified its hostility towards tribal conduit financing by suggesting that allowing tribes to use the conduit mechanism would “would run counter to Congressional intent.”<sup>320</sup> Even though the very legislative history cited in the TAM suggests that water treatment plants fall squarely within the definition of an essential governmental function,<sup>321</sup> the IRS is nonetheless challenging the tax-exempt bonds issued by the Morongo tribe for “water and wastewater system improvements, roadway improvements, and public parking facilities.”<sup>322</sup>

As discussed earlier, the IRS's most publicized enforcement of the essential governmental function test occurred in August of 2002 when the IRS advised the Las Vegas Paiutes that construction of a public golf course is “other than an essential governmental function within the meaning of § 7871(e).”<sup>323</sup> The IRS advised that it would deny the tax-exemption based on its reading of the

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<sup>316</sup> IRS Research Summary

<sup>317</sup> See Alison L. McConnell, *IRS' Anderson Says Attorneys At Fault for Tribal Bond Confusion*, BOND BUYER, September 22, 2005; see discussion of IRS enforcement at Part IV.E *infra*.

<sup>318</sup> FSA at 5.

<sup>319</sup> PLR 200603028 issued October 11, 2005.

<sup>320</sup> *Id.* at 6.

<sup>321</sup> H.R. Conf. Rep. No. 97-984, at 16-17.

<sup>322</sup> See Rick Saskal, *IRS Takes Closer Look at Calif. Tribal Deal's Tax-Exempt Status*, BOND BUYER, August 30, 2005.

<sup>323</sup> IRS Field Service Advice Memorandum No: 20024712 (date of release Nov. 22, 2002) [hereinafter FSA].

“customary use” definition provided by the 1987 amendment. The IRS acknowledged that “it is likely that construction and operation of golf courses are customary governmental functions,” but nonetheless concluded that the admittedly commercial nature of the project rendered it outside the scope of the tribe’s tax-free bond authority as limited by section 7871(e). The IRS reasoned that Congress did not define “customarily” in the statute and that “there is an argument” that such commercial ventures cannot be considered within section 7871(e). Section 7871(e) simply defines “essential governmental function” as excluding projects “not customarily performed by State and local governments.” It says nothing of the commercial or non-commercial nature of those activities.<sup>324</sup> Mary J. Streitz of Dorsey & Whitney explains that

[o]ver-relying on selected portions of the legislative history, the FSA suggested that tribal governments may not finance “commercial or industrial facilities” with tax-exempt bonds *even where such facilities satisfy the customary performance test*. Although the House Ways and Means Committee had indicated a concern about tribal governments financing commercial and industrial activities with tax-exempt bonds, the committee chose to adopt only the customary performance test to address its concerns.<sup>325</sup>

Streitz concludes that “[t]he entire legislative history reinforces that the statutory test turns on the frequency of a government practice, not on any other requirement.”<sup>326</sup>

The argument set forth by the IRS is that the golf course was not “intended to meet the recreational needs of [the] Tribe or that it is anything other than a commercial enterprise of [the] Tribe.”<sup>327</sup> Although other public golf courses can be considered essential governmental functions, in this case “the probable role of the Golf Course in the community contrasts with that of the more typical golf course developed by a state or local government.”<sup>328</sup> Given the unlikelihood that tribal members would use the course for recreational uses, the “Golf Course could be seen as disproportionate when viewed as a community amenity, making the balance between community recreation and commercial implications more significantly tilted toward the latter than is likely to be typical.”<sup>329</sup> Mary Streitz counters that, in this analysis, the FSA overlooks the fact that “many state and local government golf courses are “destination” golf courses intended to attract visitors from *outside* the community in which the golf course is located, thus promoting economic development in the community and raising revenues for the state or local government” (emphasis in original).<sup>330</sup> Therefore, the FSA essentially says that Indian tribes cannot utilize tax-free debt to construct golf courses and accompanying club houses if the courses pass a subjective line of being too nice for tribal members. One wonders if the same public course in a place like Palm

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<sup>324</sup> I.R.C. § 7871(e).

<sup>325</sup> Mary J. Streitz, *Letter to Timothy L. Jones, Internal Revenue Service, Tax Exempt Bonds* (November 26, 2002) (emphasis in original).

<sup>326</sup> *Id.* at 2.

<sup>327</sup> FSA at 5.

<sup>328</sup> *Id.*

<sup>329</sup> *Id.*

<sup>330</sup> Streitz, *supra* note 325, at 3.

Beach would encounter these same difficulties. The FSA admits that all publicly built and operated golf courses “are developed to enhance the lifestyle of both golfing and non-golfing citizens of the community and perhaps to create jobs,” but nonetheless denies the tribe’s admitted effort to “further the economic development of [the] Tribe and to reduce [the] Tribe’s dependence on” its limited available resources,<sup>331</sup> because these are commercial rather than recreational pursuits.

The FSA noted that “[t]he legislative history of § 7871(e) indicates that Congress meant not to include commercial or industrial facilities as essential governmental functions even if such functions were **commonly financed** with tax-exempt bonds by state or local governments.”<sup>332</sup> Indeed, the legislative history indicates that tribes were faced with a more limited authority than states and municipalities. As noted above, the House Committee Report on the 1987 amendment stated that only customarily publicly-financed projects are intended to be within the tribes’ authority, “notwithstanding that *isolated instances* of a state or local government issuing bonds for another activity may occur.”<sup>333</sup> Thus, the IRS at once acknowledged that “there were at least 2,645 public golf courses in 1998...and it is probable that the number has grown,”<sup>334</sup> and in the same FSA memorandum, relied on legislative history deeming projects that may be financed by states with tax-free bonds “in isolated instances” beyond tribal authority.

The FSA recommended not litigating the bond exemption because it would “be difficult to argue that Golf Course is so commercial in nature that state and local governments would not own and operate similar enterprises.”<sup>335</sup> Additionally, it acknowledged that “some courts, including the Tenth Circuit, have adopted the principle that federal statutes are to be construed liberally in favor of Native Americans, with ambiguous provisions interpreted to their benefit.”<sup>336</sup> In short, the IRS’ position was untenable based on existing public practices and judicial rulings, but it nonetheless proceeded with hostile enforcement actions.

The 2002 FSA has inspired a number of criticisms, most recently in the form of a report issued by the Advisory Committee to the Internal Revenue Service on Tax Exempt and Government Entities (“ACT”).<sup>337</sup> The ACT Report is harshly critical of the FSA, emphasizing that public golf courses are in fact customarily owned and operated by state and local governments. The ACT Report further requests that the IRS cease any new audits and enforcement initiatives, withdraw the 2002 FSA memorandum, and most importantly, clarify that essential governmental functions for purposes of section 7871 be construed in accordance with the term “essential governmental function” as it is used in section 115 of the

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<sup>331</sup> FSA at 5. (Note that this sentence was blacked out where the quote ends. This is the author’s interpretation of this part of the FSA).

<sup>332</sup> *Id.* (emphasis added).

<sup>333</sup> H. R. No. 100-391 at 1139 (emphasis added).

<sup>334</sup> FSA at 6.

<sup>335</sup> *Id.*

<sup>336</sup> *Id.*

<sup>337</sup> See *Etc*city supra note 3; see also Lenor A. Scheffler and Robert L. Gips, “Survey and Review of Existing Information and Guidance for Indian Tribal Governments” (available at <http://www.irs.gov/pub/irs-tege/p4344.pdf>).

Internal Revenue Code for benefits accruing to state and local governments.<sup>338</sup>

Section 115 provides that gross income “does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.”<sup>339</sup> The IRS takes a broad view of what is excludable under section 115.<sup>340</sup> In determining whether the entity can exclude its income from federal income tax liability, the IRS employs a three-part test: 1) whether the entity makes or saves money for a state or local government, 2) whether its assets revert to the state upon dissolution, and 3) whether there is any private benefit.<sup>341</sup> In a sharp contrast to its approach in the 2002 FSA to defining an essential governmental function as excluding any commercial activity, the IRS has reasoned that a state investment fund for cash balances constitutes an essential governmental function because “it may be assumed that Congress did not desire in any way to restrict a state’s participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.”<sup>342</sup>

As mentioned earlier, several states have even issued tax-exempt bonds in support of their gaming operations such as lotteries and horse racing.<sup>343</sup> Similarly, a number of municipalities have financed hotels and convention centers with tax-exempt bonds.<sup>344</sup> Given the uncertainty as to whether these activities have reached a level of “customary” occurrence, tribes have thus far been unable to borrow directly on a tax-exempt basis to finance their own casinos or other gaming facilities.<sup>345</sup> For purposes of section 115, however, the IRS has, without intervention by Congress, effectively defined *any* activity that makes or saves the government money as an essential governmental function. This definition encompasses the very purpose of the Las Vegas Paiute Golf Course, which the IRS has reasoned does not qualify as an essential governmental function.<sup>346</sup>

Despite the arguably racist heritage of the essential governmental function test, the IRS is also using that test to justify its hostility against tribal conduit financing. Despite the formal legality of the conduit arrangements, the IRS has begun to scrutinize conduit borrowing engaged in by Indian tribes, arguing that “[i]n general, any transaction done indirectly that cannot be done directly is troubling.”<sup>347</sup>

All the tribal conduit borrowings have been reported as under scrutiny by the

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<sup>338</sup> Ettecity supra note 3.

<sup>339</sup> I.R.C. § 115.

<sup>340</sup> See John F. Theberge and Diana A. Imholtz, *Tax-Exempt Financings Involving Indian Tribal Governments*, The Tax Exempt Organization Tax Review 181, August 2003.

<sup>341</sup> See *id.* at 182 (citing Ellen P. Aprill, *The Integral, the Essential, and the Instrumental: Federal Income Tax Treatment of Governmental Affiliates*, 23 J. CORP. L. 803, 814 (Summer 1998)).

<sup>342</sup> See *id.* at 182 (quoting Rev. Rul. 77-261).

<sup>343</sup> See Part III.C.2., *supra*.

<sup>344</sup> See Part III.C.2., *supra*.

<sup>345</sup> See Hyatt, Israel, *et al*, *supra* note 24, p. 19.

<sup>346</sup> FSA at 5.

<sup>347</sup> See Susanna Duff Barnett, *\$145.5M Cabazon Deal Under Scrutiny IRS Steps Up Probes of Indian Tribes*, BOND BUYER, August 06, 2004 (quoting Charles Anderson, manager of field operations for the IRS tax exempt bond division).

IRS.<sup>348</sup> One involves two hotel and casino complexes in Florida built by the Seminole Tribe, one in Tampa and one in Hollywood. These projects together utilized \$345 million in tax-exempt bonds.<sup>349</sup> The conduit issue for these projects was the Capital Trust Agency, an entity created by the city of Gulf Breeze and the town of Century, both in Florida.<sup>350</sup> Another publicly scrutinized conduit borrowing involves the Cabazon Band of Mission Indians in which the California Statewide Communities Development Authority issued \$145 million in tax-exempt bonds.<sup>351</sup> In the Cabazon case, the tribe received a letter from the IRS indicating that the tribe “may have issued an obligation substantially all of the proceeds of which were not to be used in an exercise of an essential governmental function of the tribe.”<sup>352</sup> The IRS recently issued a technical advice memorandum taking the position that tribal proceeds from conduit financings are subject to the “essential governmental function” test.<sup>353</sup> This memorandum was criticized by Mark A. Jarboe of Dorsey & Whitney LLP as an instance of the IRS taking “a results-oriented approach to creating an ambiguity because of what they think Congress meant rather than what Congress said.”<sup>354</sup>

Aside from the IRS’s investigation of this method of tribal financing, conduit financing itself is a far less efficient method of accessing tax-free debt than direct issuance by a tribe. Consider the Seminole case, where issuance costs amounted to 9.2% of the bond proceeds.<sup>355</sup> These fees cut into the amount available for investment in the tribal enterprise, making the tribe’s income-generating effort less

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<sup>348</sup> While only two cases are discussed in this part of the article, the discussion is meant to be only a representative, and not an exhaustive description of the activities by the IRS against tribal bond issuers, as Charles Anderson, field operations manager for the IRS tax-exempt bond office, has stated that at least six tribal conduit bonds are currently being challenged by the IRS. See Alison L. McConnell, *IRS’ Anderson Says Attorneys At Fault for Tribal Bond Confusion*, BOND BUYER, September 22, 2005. Tax attorneys in the field have privately stated that actually only five tribal conduit bonds have been challenged and that only five tribal conduit bonds have been issued. Reports by the Bond Buyer seem to support this assertion. See Susanna Duff Barnett, *\$145.5M Cabazon Deal Under Scrutiny IRS Steps Up Probes of Indian Tribes*, BOND BUYER, August 6, 2004 (discussing IRS examination of \$145.5 million in tax-exempt bonds issued by the California Statewide Communities Development Authority on behalf of Cabazon’s East Valley Tourist Development Authority); Shelly Sigo, *IRS Queries Fla. Tribe’s Use of Bonds Casino-Hotel May Be Private Activity*, BOND BUYER, May 7, 2004 (discussing IRS examination of \$345 million in tax-exempt bonds issued by Capital Trust Agency on behalf of Seminole Tribe in 2002); Emily Newman, *IRS to Audit Seminole Tribe of Florida’s \$124 Million of Tax-Exempt Bonds*, BOND BUYER, February 3, 2005 (discussing IRS examination of \$124 million in tax-exempt bonds issued by Capital Trust Agency on behalf of Seminole Tribe in 2003 and 2004); Rich Saskal, *IRS Takes Closer Look at Calif. Tribal Deal’s Tax-Exempt Status*, BOND BUYER, August 30, 2005 (discussing IRS examination of \$51 million in tax-exempt bonds issued on behalf of Morongo Band of Mission Indians in 2004 for water and wastewater system improvements).

<sup>349</sup> See Shelly Sigo, *IRS Suggests Private-Letter Rulings to Casino-Building Tribes*, BOND BUYER, May 14 2003.

<sup>350</sup> *Id.*

<sup>351</sup> See Barnett *supra* note 347.

<sup>352</sup> *Id.*

<sup>353</sup> IRS Technical Advice Memorandum TAM-142470-05, PLR 200603028, 2005 PLR Lexis 1322 (October 11, 2005, release date January 20, 2006).

<sup>354</sup> Alison L. McConnell, *IRS: ‘Essential governmental function’ Needed for Conduit Debt*, BOND BUYER, January 23, 2006.

<sup>355</sup> See Sigo *supra* note 349.

effective and certainly far less efficient than a direct issuance. Clearly, the source of this method of debt-financing, untoward, in the eyes of the IRS, and expensive, for tribes, is an outgrowth of the stifling effect of the essential governmental function requirement on tribes' direct access to the tax-free market. The conduit approach would be altogether unnecessary, however, if the discriminatory aspects of §7871 were eliminated.

#### CONCLUSION

##### *A. The Policy Reasons for Expanding Indian Tribes' Tax-Free Bond Authority*

In the past the federal government has shifted its policy toward American Indians with the policy ranging from evacuation of Indians from their native lands in a "trail of tears" to a "reorganization" effort to anglicize Indians to complete "termination" of the tribal structure.<sup>356</sup> In the late 1960s the federal government abandoned the policy of termination in favor of the policy of tribal "self-determination" in order to strengthen both the federal government's service programs for Indian tribes and increase the ability of tribes to design and operate their own programs.<sup>357</sup> Commentators have described the failed effort in 1975 to place tribes on equal footing with states in the Tax Code as part of this era of self-determination efforts.<sup>358</sup> The authority to supplement tax revenue by issuing tax-free debt obligations is clearly a major part of any state's efforts to develop and maintain its infrastructure and economy.<sup>359</sup> The policy of self-determination, along with the legal recognition of tribes as governments with responsibilities to their constituent populations, necessitates tax-free bond authority.

Yet tribes, to this day, and as a direct consequence of the essential governmental function requirement, do not enjoy such authority to any meaningful degree. Not only are these restrictions discriminatory against Indian tribes, inconsistent with the federal policy of self-determination and contrary to the legal recognition of tribes as governments, but also they are a stifling repression of the efforts of the historically most impoverished, isolated, and disaffected minority group<sup>360</sup> in the nation to improve their daily lives. Indeed, although the law now technically grants tribes tax-free bond authority, the essential governmental function test in reality renders this power one that exists in theory only.<sup>361</sup>

Williams concluded that the 1982 legislation and its failure to provide the much needed tax-free bond authority equal to that of states indicated both that "Congress ignored the express desires of the Indian tribes," and that "non-Indian policymakers are still insensitive to Indian preferences – an attitude that has

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<sup>356</sup> See generally, HANDBOOK II, *supra* note 7, at 180-206.

<sup>357</sup> The key legislation of this era includes: The Indian Self-Determination and Education Assistance Act of 1975 (Pub. L. 93-638 (codified at 25 USC §§ 450 *et seq.*); The Indian Civil Rights Act of 1968 (codified at 25 USC §§ 1301-1341); The Indian Financing Act of 1974 (codified at 25 U.S.C. § 1451); and the Indian Child Welfare Act of 1978 (codified at 25 U.S.C. §§ 1901-1963). See generally HANDBOOK II, *supra* note 7 at 188-204.

<sup>358</sup> See April *supra* note 27, at 343 (describing the 1975 lobbying effort as part of the greater Indian effort to achieve "economic independence.")

<sup>359</sup> See *supra* Part I.

<sup>360</sup> See *infra* notes 147-150, and accompanying text.

<sup>361</sup> See Williams *supra* note 27, at 382.

characterized the long and dismal history of federal Indian development policy.”<sup>362</sup> Even today, most Indian tribes find themselves in a territorially remote location, cut off from easy access to capital markets, out of sight and mind from investors, and stuck with a crippling, third-world level of infrastructure.<sup>363</sup>

In addition to the investment and employment issues, most tribes’ lack of a natural and diversified tax base also limits their ability to raise revenue.<sup>364</sup> The lack of a tax base both heightens the need for alternative sources of revenue, such as tax-free debt, and hinders the ability to issue general obligation bonds backed by the full faith and credit of the tribe.<sup>365</sup> Thus, in the arena of tax-free bonds, allowing tribes to use debt obligations to finance projects normally provided by the private sector but lacking in Indian country, such as mortgage bonds or owner occupied housing, would be a sensible and fair policy. In enacting tribal bond legislation, however, Congress has chosen not to consider alternatives that would address these deeply rooted obstacles facing tribes. Despite the rhetoric paid to recognizing tribes as governments and equalizing their tax treatment with that of states, Congress gave tribes a limited authority to utilize tax-free debt obligations that resulted in only seven known issuances.<sup>366</sup> Even with this small use of this limited bond authority, Representative Gibbons spearheaded an effort in Congress that further limited tribes’ bonding abilities. The result is that tribes are effectively limited to their general obligation bonding capabilities, which, as noted earlier, is largely illusory for economically strapped Indian tribes.

This problem is particularly acute for poor tribes. Tribes with substantial natural resources or significant gaming operations have the option of financing certain activities on a taxable basis even if, absent a racist Tax Code, they would be able to finance those activities on a tax-exempt basis. Poorer tribes, however, do not have that luxury, and more than \$50 billion in annual capital needs still go unmet in Indian Country,<sup>367</sup> in part because the debt service required to finance the projects to meet those needs is too expensive at taxable rates.

Given the level of “commercial” activity by states and local governments that is funded with tax-exempt debt, the expanding hostility towards revenue generating activity by tribal governments is indefensible in any intellectually honest manner. Congress itself has recently passed legislation that acknowledges that tribally sponsored commercial activities can nonetheless be essential governmental functions.<sup>368</sup> This recent pronouncement provides an opening for

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<sup>362</sup> *Id.* at 388-89.

<sup>363</sup> For an extensive discussion of the myriad of obstacles facing Indian tribes’ efforts to develop their own economies, see Williams *supra* note 27 at 340-56.

<sup>364</sup> See Aprill *supra* note 27 at 357-60.

<sup>365</sup> *Id.*

<sup>366</sup> See Aprill *supra* note 27 at 357.

<sup>367</sup> See Henson, E. and J. Taylor, *Native America at the New Millennium*, Harvard Project on American Indian Economic Development Working Paper, 2003.

<sup>368</sup> See Pension Protection Act of 2006, H.R. 4, 109th Congress (2006). Among the sweeping changes to ERISA contained in the Act, Section 906 “clarifies” the applicability of the “governmental plan” exemption from ERISA to employee benefit plans of tribal governments and related entities, such as vesting and funding rules. Although several earlier pieces of legislation attempted to make clear that the governmental plan exemption to ERISA and related Code provisions should be available to tribal government plans (See, e.g. H.R. 331, H.R. 2830 and S. 673, 109th Congress),

Congress to act on the issue of tribal tax-exempt bonds. Tribal governments need the ability to issue tax-exempt debt on the same basis as state and local governments. To continue to deny them such ability is to continue to foster a racist Tax Code.

### *B. Proposed Legislative Solution*

As discussed in Part II, tribes are similarly situated to states in terms of their governmental obligations to their citizens. Tribes also enjoy a significant degree of sovereignty as domestic dependent nations. Therefore, tribes should, as a matter of both policy and equity, enjoy an identical status as states in the Tax Code, including the broad ability to issue tax-free debt. Although legislative proposals have been offered in the past that would put rectify the inequities in §7871 and put tribal debt on an equal footing with municipal debt for tax law purposes, such legislation has yet to pass.<sup>369</sup>

Indian tribes have for centuries existed in a kind of dual world where they are sovereigns for some purposes but treated as if their governmental responsibilities are not real for other purposes. The Tax Code's restriction on tribal tax-free bonding authority is an example of the latter. This restriction is an unjustifiable discrimination against Indian tribes by the Congress in the enacting legislation and by the IRS in its enforcement actions. Moreover, the official federal policy of Indian Tribal Self-Determination requires meaningful access to the tax-free bond market if it is to be successful.

The Supreme Court's view of economic development as an essential governmental function bears repeating:

Promoting economic development is a traditional and long accepted governmental function, and there is no principled way of distinguishing it from the other public purposes the Court has recognized.<sup>370</sup>

Unfortunately, the Supreme Court was not opining on an Indian law case but was instead discussing economic development in the municipal context.

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what emerged from the Conference Committee ultimately enacted into law appears to almost completely remove the availability of the exemption for tribes and related entities. Interestingly, however, Section 906 of the Act provides that a "governmental plan" will include "a plan which is established and maintained by an Indian tribal government..., a subdivision of an Indian tribal government..., or an agency or instrumentality of either, and all of the participants of which are employees of such entity substantially all of whose services as such an employee are ***in the performance of essential government functions but not in the performance of commercial activities (whether or not an essential government function)***" (emphasis added). This statutory language clearly states that a revenue generating activity, although commercial in nature, can still be an essential government function, thus eviscerating the basis upon which the IRS has generally opposed tax-exempt bond financings under the "essential governmental function" test. Section 906 itself is clearly discriminatory, as pension plans for employees of state-run enterprises such as the liquor store employees of the New Hampshire State Liquor Commission are still able to enjoy the "governmental plan" exemption from ERISA, but a single employee of a tribal gift shop for a tribe with no other commercial activities would deny the entire tribe the ability to have their pension treated as a governmental plan.

<sup>369</sup> See e.g. H.R. 2253, 107th Congress (2001); S.1637, 108th Congress (2004). S.1637 was passed by the Senate, but its tribal tax-exempt bond provisions were eliminated by the Conference Committee in its effort to reconcile with H.R. 4520, which did not contain the tribal provisions.

<sup>370</sup> Kelo v. City of New London, \_\_ US \_\_ (2005)

Under the status quo, the Tax Code and the IRS are systematically discriminating against tribal governments relative to state and local governments. Congress has the opportunity to rectify this differential treatment simply by rewriting section 7871 to treat tribes as states for all tax purposes, without qualification:

Sec. 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 [26 USCS § 170] (relating to income tax deduction for charitable, etc., contributions and gifts),

(B) sections 2055 and 2106(a)(2) [26 USCS §§ 2055 and 2106(a)(2)] (relating to estate tax deduction for transfers of public, charitable, and religious uses), or

(C) section 2522 [26 USCS § 2522] (relating to gift tax deduction for charitable and similar gifts);

(2) for purposes of any exemption from, credit or refund of, or payment with respect to, an excise tax imposed by--

(A) chapter 31 [26 USCS §§ 4001 et seq.] (relating to tax on special fuels),

(B) chapter 32 [26 USCS §§ 4064 et seq.] (relating to manufacturers excise taxes),

(C) subchapter B of chapter 33 [26 USCS §§ 4251 et seq.] (relating to communications excise tax), or

(D) subchapter D of chapter 36 [26 USCS §§ 4481 et seq.] (relating to tax on use of certain highway vehicles);

(3) for purposes of section 164 [26 USCS § 164] (relating to deduction for taxes);

(4) for purposes of section 103 [26 USCS § 103] (relating to state and local bonds);

(5) for purposes of section 511(a)(2)(B) [26 USCS § 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) [26 USCS § 105(e)] (relating to accident and health plans),

(B) section 403(b)(1)(A)(ii) [26 USCS § 403(b)(1)(A)(ii)] (relating to the taxation of contributions of certain employers for employee annuities), and

(C) section 454(b)(2) [26 USCS § 454(b)(2)] (relating to discount obligations); and

(7) for purposes of--

(A) chapter 41 [26 USCS §§ 4911 et seq.] (relating to tax on excess expenditures to influence legislation), and

(B) subchapter A of chapter 42 [26 USCS §§ 4940 et seq.] (relating to private foundations).

(b) 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 such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

(Sections (c), (d), and (e) should be repealed).

For the sake of consistent federal policy toward Indian tribes, for the sake of

tribes' right to economic independence, and for the sake of eliminating a harmful and discriminatory law, Congress should act to equalize tribal bond authority with that of states.

*C. Positive Federal Revenue Impact*

In addition to the policy rationale for eliminating racism in the tax code by equalizing tribal tax-exempt bonding authority, such an expansion would actually increase federal tax revenues. Given the high levels of unemployment throughout Indian Country, there are no labor market constraints, and thus any jobs created as a result of projects funded with tax-exempt bonds will likely be filled by previously unemployed individuals. Those individuals will pay income and social security taxes, and their employers will contribute additional payroll taxes. Even without factoring in the reduction in welfare transfer payments that result from increased employment and increased per capita income, economic models clearly demonstrate the positive federal revenue impact of increase tribal bonding authority.<sup>371</sup>

Conversely, the maintenance of the current restrictions on tribal tax-exempt bonding authority have a negative impact on federal tax revenues. Since these restrictions keep otherwise viable projects from being funded, the federal treasury is losing out on tax revenues that would otherwise be generated in the absence of these restrictions. Sound fiscal logic and the obvious policy imperative strongly suggest that Congress should eliminate the racist restrictions on tribal tax-exempt bonding authority.

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<sup>371</sup> See Clarkson testimony, *supra* note 41, financial model.