JOINT COMMENTS
OF

National Congress of American Indians
Native American Finance Officers Association
United South and Eastern Tribes, Inc.
The Affiliated Tribes of Northwest Indians
California Association of Tribal Governments

Submitted Via Federal eRulemaking Portal:
@ www.regulations.gov (IRS-REG-133223-08).

RE: Comments to Advance Notice of Proposed Rule Making
IRS-REG 133223-08
Internal Revenue Code Section 414(d)

Regulations Drafting Group:

The purpose of this letter is to provide comments on the Advance Notice of Proposed Rule Making, IRS-REG 133223-08 (the "Proposed Rule") issued on November 7, 2011 on defining "essential government functions" and "commercial activities" under Internal Revenue Code (the "Code") Section 414(d).

I. Introductory Statement

Indian tribal governments have a unique status in our federal system under the U.S. Constitution and numerous federal laws, treaties and federal court decisions. They have a governmental structure, and have the power and responsibility to enact civil and criminal laws regulating the conduct and affairs of their members and reservations. They operate and fund courts of law, police forces, and fire departments. They provide a broad range of governmental services to their citizens, including education, transportation, public utilities, health, economic assistance, and domestic and social programs. Like the income of states and local governments, tribal revenues are not treated as taxable income – but as the governmental revenues of a distinct sovereign. Any guidance on defining "essential government functions" or "commercial activities" must be consistent with federal law and policy and must reflect the sovereign status of tribes, the federal trust relationship, and the federal policy of self-determination.

Brief History

When the Employee Retirement Income Security Act ("ERISA") was adopted in 1974, it drew a line between government sector and private sector employers. Private employers were subject to ERISA and a new set of Code requirements and regulations. Government employers were exempt.

The decision to treat governments differently was not an oversight. There were concerns that ERISA would infringe on sovereignty if applied to government employers. It was recognized that governments could raise tax revenues to secure benefit promises, if needed, while private companies could not. Congress understood that government employers were already subject to oversight through the political process and election cycles, while private employers were not. And the "equities" favoring ERISA regulation did not apply. In exchange for the added regulation of ERISA, private sector employers received "benefits" that government sector employers do not need: caps on liability (no punitive damages), limitations on jury trials, protection against conflicting state laws, and tax deductions.

Unfortunately, the original "government" definition under Section 3(32) of ERISA and Section 414(d) of the Code was silent on its treatment of tribes. While two early Circuit Court decisions addressed the applicability of ERISA to tribes under the "Coeur d'Alene test" for federal statutes of general applicability, neither case addressed whether tribal governments were nonetheless entitled to the "government" exemptions provided under ERISA and Code Section 414(d).[1]

For more than 20 years, many tribal governments throughout the country asserted government status under ERISA and Code Section 414(d). Tribes applied for and routinely received IRS determination letters under the government sector rules. And while more recent explanations by IRS convey a limited view of the scope of a government plan determination letter, tribes were comforted by them for over two decades without challenge. As tribal gaming grew in the late 1990s and early 2000s, however, tribes began to get push back from IRS and DOL on whether tribes were truly "governments" under ERISA and Code Section 414(d). Neither agency ruled against government status, but nor would either agency confirm it.[2]

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[1] See, *Smart v. State Farm*, 868 F.2d 929 (7th Cir. 1989), and *Lumber Industry v. Warm Springs*, 939 F.2d 683 (9th Cir 1991).

[2] Actual agency rulings on this issue have been sparse and inconclusive, with one of the first hints at an agency rule creating a divide between essential government functions and "commercial" activity 25 years before the PPA. In PBGC Opinion 81-3, the Pension Benefit Guaranty Corporation concluded that "Congress did not intend to extend Title IV coverage [of

This resulted in a legislative effort to clarify once and for all that tribal governments were "governments" under ERISA and Code Section 414(d). From 2003 through 2006 there were several stand alone bills introduced in Congress designed to clarify that tribal governments were to be provided equal status with state and local governments[3]. In the fall of 2006, the Senate passed a bill (S. 1783) that ultimately became the PPA. While the Senate bill included tribal parity language, however, the House bill did not.

Normally, differences between the House and Senate bills would have been reconciled in conference, with due consideration to each version. And in reconciling the absence of a tribal provision in the House bill, we would have expected consideration of prior House support for tribal equality, taking into account that the concept of tribal parity in this context actually started in the House three years earlier with the introduction of H.R. 3605, the "Governmental Pension Plan Equalization Act 2003".

The PPA, however, was pulled for a vote (for the fall election cycle) before a final conference report was issued. Unfortunately, the draft being circulated within conference at that time included a parenthetical adding the essential government function and commercial activity limitations now at issue.

While the Proposed Rule affords deference to the explanation provided by the Joint Committee on Taxation (the "Joint Committee"), that explanation should not be confused as being reflective of Congressional intent. The tribal rule received no Congressional debate. There were no Congressional hearings on the issue. The "commercial" activity test was not in any of the early versions of either the House or Senate bills. And the Joint Committee's

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ERISA] to plans maintained as a function of the Tribes' internal sovereignty". In PBGC Opinion 89-9, the same agency concluded that another tribal plan was governed by ERISA where it involved "off-reservation commercial activities carried on to make a profit". The Department of Labor has never issued a ruling on the government status of tribes under ERISA Section 3(32). Nor did IRS publish any rulings on the government status of tribes under Code Section 414(d). However, in 2004 and 2005, additional confusion was created when IRS began to rule on state police and fire fighter pension plans that were permitting tribal participation (see PLR 200402031, 200404059, 200405015, 200514024, and 200541048). The "police plan" rulings appeared to have been concentrated in "PL 280" jurisdictions, leaving non-PL 280 tribes and states wondering how tribal participation would be treated under Code Section 414(d).

[3] See, e.g., H.R. 3605, 108th Congress, November 21, 2003, the "Governmental Pension Plan Equalization Act of 2003"; and H.R. 331, 109th Congress, the "Governmental Pension Plan Equalization Act of 2005".

explanation stems from concepts that have since been acknowledged as unworkable in other areas of taxation. Treasury, in fact, has since recommended that the essential government function tests be entirely eliminated in the context of tax exempt bonds. As the guidance is developed, then, we urge Treasury and IRS to retreat using the Joint Committee explanation as a foundation for the rules at hand.

Call for a Legislative Fix

In the final analysis we are left with concepts added during a conference process that was not completed, that are inconsistent with all prior House and Senate efforts on this issue, that received no debate or input from tribes in the legislative process, have proven unworkable in other areas of taxation, and have now gone almost a decade with no substantive guidance in defining the standards and rules needed to coordinate day to day plan compliance.

The essential government function and commercial activity tests cannot be reconciled in this area any more than they could in the area of tax exempt bonds. We request that Treasury support legislative efforts to eliminate these tests under Code Section 414(d) for the same reasons they should be eliminated under Code Section 7871.

We also point to the failed attempts throughout history at drawing lines between governments performing "government" functions and governments performing "business" functions, and caution against a new regulatory scheme that builds too much upon distinctions that will produce unworkable results. The case of *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 541-542 (1985), is instructive in this regard. In *Garcia*, the Supreme Court, while reviewing the history of state tax immunity cases, explained the inherent problems in trying to distinguish “governmental” from “business” activities:

> “If these tax-immunity cases had any common thread, it was in the attempt to distinguish between ‘governmental’ and ‘proprietary’ functions. To say that the distinction between ‘governmental’ and ‘proprietary’ proved to be stable, however, would be something of an overstatement. In 1911, for example, the Court declared that the provision of a municipal water supply ‘is no part of the essential governmental functions of a State’’ *Flint v. Stone Tracy Co.*, 220 U.S. 107, 172, 31 S.Ct. 342, 357, 55 L.Ed. 389. Twenty-six years later, without any intervening change in the applicable legal standards, the Court simply rejected its earlier position and decided that the provision of a municipal water supply *was* immune from federal taxation as an essential governmental function, even though municipal water-works long had been operated for profit by private industry. *Brush v. Commissioner*, 300 U.S., at 370-373, 57 S.Ct., at 500-502. At the same

> time that the Court was holding a municipal water supply to be immune from federal taxes, it had held that a state-run commuter rail system was *not* immune. *Helvering v. Powers*, 293 U.S. 214, 55 S.Ct. 171, 79 L.Ed. 291 (1934). Justice Black, in *Helvering v. Gerhardt*, 304 U.S. 405, 427, 58 S.Ct. 969, 978, 82 L.Ed. 1427 (1938), was moved to observe: 'An implied constitutional distinction which taxes income of an officer of a state-operated transportation system and exempts income of the manager of a municipal water works system manifests the uncertainty created by the 'essential' and 'non-essential' test' (concurring opinion). It was this uncertainty and instability that led the Court shortly thereafter, in *New York v. United States*, 326 U.S. 572, 66 S.Ct. 310, 90 L.Ed. 326 (1946), unanimously to conclude that the distinction between "governmental" and "proprietary" functions was "untenable" and must be abandoned."

Id. After citing numerous examples of failed attempts to regulate state governments based upon a notion of what is "essential" "historical", "necessary", or "proprietary", the Court noted the following passage that we now assert should be reflected in the regulatory project at hand:

> "[T]here is a more fundamental problem at work here, a problem that explains why the Court was never able to provide a basis for the governmental/proprietary distinction in the intergovernmental tax-immunity cases and why an attempt to draw similar distinctions with respect to federal regulatory authority [] is unlikely to succeed regardless of how the distinctions are phrased. The problem is that neither the governmental/proprietary distinction nor any other that purports to separate out important governmental functions can be faithful to the role of federalism in a democratic society. The essence of our federal system is that within the realm of authority left open to them under the Constitution, the States [and tribal governments] must be equally free to engage in any activity that their citizens choose for the common weal, no matter how unorthodox or unnecessary anyone else-including the judiciary-deems state [or tribal] involvement to be. Any rule [] that looks to the "traditional," "integral," or "necessary" nature of governmental functions inevitably invites an unelected [body] to make decisions about which state [or tribal] policies it favors and which ones it dislikes. . . There is not, and there cannot be, any unchanging line of demarcation between essential and non-essential governmental functions. Many governmental functions of today have at some time in the past been non-governmental. The genius of our government provides that, within the sphere of constitutional action, the people-acting not through the courts but through their elected legislative representatives-have the power to determine as conditions demand, what services and functions the public welfare requires."

Garcia at 545, 546. From these lessons noted by the Supreme Court in *Garcia*, we urge Treasury and IRS to support an effort to eliminate the essential government function and commercial distinctions in their entirety. Until the statutory language can be fixed, however, we urge Treasury and IRS to exercise their regulatory discretion in minimizing the impact if this poorly drafted language by construing these terms in the most favorable light permitted by the statutory language at hand.

II. Tribal Sovereignty, the Federal Trust Responsibility, Self-Determination; and Canons of Tribal Construction

The National Congress of American Indians, the Native American Finance Officers Association, the United South and Eastern Tribes, the Affiliated Tribes of Northwest Indians, and the California Association of Tribal Governments recently joined together in commenting on the general welfare exclusion (the "GWE"). As with our comments under the GWE, we urge Treasury and IRS in the development of rules under the PPA to take into account the backdrop of inherent tribal sovereignty, federal treaties and the trust responsibility, tribal history and social and economic conditions, and the federal policy of tribal self-determination.

Indian tribal governments have a unique status in our federal system under the U.S. Constitution and numerous federal laws, treaties and federal court decisions. They have governmental structures, power and responsibility. They enact civil and criminal laws, provide government services (including courts of law, police, fire protection, schools, housing, utilities, transportation, social services and health), and are generally treated in the same manner as states under the Indian Tribal Governmental Tax Status Act of 1982, which is codified at Section 7871 of the Internal Revenue Code (the "Code").

The federal trust responsibility is derived from the long history of treaties and agreements between the federal government and Indian tribes, and establishes the obligation of the United States to provide for the continued viability of tribal self-government, tribal communities and tribal cultural practices. This includes federal recognition of the power that tribes possess to determine their own form of government, and to organize and govern to meet the needs of their citizens. *See, e.g., Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 62 (1978) (noting that in enacting the Indian Civil Right Act, Congress intended "to promote the well-established federal policy of furthering Indian self-government" by adapting the safeguards of the Bill of Rights "to fit the unique political, cultural, and economic needs of tribal governments") (internal quotations omitted).

The official policy of the United States with regard to tribal-federal relations has changed over the years. From 1887 through 1934, the United States followed a policy of "allotments and assimilation". With the enactment of the Indian Reorganization Act in 1934 and continuing through 1953, the focus shifted to reorganization and constitutional reform of tribal government. From 1953 through 1968, the policy took a harsh turn toward "termination and relocation", with the government status of many tribes terminated during that period. From 1968 to the present, the official policy of the United States has been to promote "tribal self-determination".

Guidance under Code Section 414(d) must reflect the official policy of the United States government to promote tribal self determination. Denying government status to tribal activities that generate revenue needed for self-determination would contravene that policy.

The Section 414(d) guidance must also reflect well settled canons of construction with regard to the application of federal statutes to Indian tribes. The United States Supreme Court has stated that "statutes are to be construed liberally in favor of the Indians with ambiguous provisions interpreted to their benefit " See *Montana v. Blackfeet Tribe*, 471 U.S. 759, 766, 105 S. Ct. 2399, 85 L.Ed.2d 753 (1985)). Under this rule, it is not enough that the Proposed Rule reflect a possible or even reasonable reading of Code Section 414(d). Code Section 414(d) must be construed liberally in favor of tribes with ambiguities resolved in their favor.

Finally, the Proposed Rule contains a statement regarding the scope of consultation that must be removed. The Proposed Rule provides that the essential government function test does not "have substantial direct effects with respect to the Federal government and Indian tribes" and concludes, therefore, that these subjects are not subject to consultation under Executive Order 13175. We contend that the determination of essential government functions and government status under PPA are precisely the types of issues that must be subject to consultation. The final rules should expressly require consultation in the event of a disagreement between IRS and a tribe in applying rules that are inherently fact based with a high degree of discretion, and permit flexibility that will include the ability of individual tribes to seek waivers as called for in Executive Order 13175, Section 6.

III. Developing Substantive Guidance Consistent with Federal Indian Law and Policy:

The National Congress of American Indians, the Native American Finance Officers Association, the United South and Eastern Tribes, the Affiliated Tribes of Northwest Indians, and the California Association of Tribal Governments contend that the Proposed Rule should be amended in several key respects:

1. The final rule must maximize parity to the fullest extent permitted by the statutory language at hand.

Code Section 414(d) should be construed to provide as much parity between tribal and state governments as permitted by the statutory language at hand. We understand that the statute is flawed and needs to be amended for complete parity. However, the Proposed Rule falls far short of what can be achieved through regulatory discretion until the legislation can be fixed.

The final rule should minimize the differences between tribal and state governments by expressly recognizing government treatment for revenue generating activities on par with those performed by state and local governments.

The phrases "essential government functions" and "commercial" in nature are not defined in the statute or in any legislative history. In fact, these phrases are inherently ambiguous and susceptible to many different meanings depending on the context.

It is certainly reasonable to construe the term "essential government function" as including any activity that is carried on to preserve or promote tribal self determination, health, education and welfare, including the maintenance of culture and tradition. Commercial activities could certainly be read to prohibit only the activities that are carried on for private rather than public interests, and (for parity) not to exclude any revenue generating activity similar in scope, purpose or result to those carried on by state and local governments.

While we understand the reading afforded by the Joint Committee and reiterated in the Proposed Rule, a more parity oriented reading is just as plausible under the statutory language at hand. One may "guess" that Congress intended to limit any "business-like" activities or that Congress meant to target Casinos, Hotels, Marinas and Convenience Stores. However, a "guess" does not have the force of legislative intent. We are aware of no evidence of Congressional intent to limit tribal government status in that manner.

In fact, we contend that the most deferential reading of this rule possible is required by the trust responsibility, policy of self-determination and canons of construction set forth above.

State and local governments can operate hotels, convention centers, lotteries, stores and golf courses without loss of government status. Those activities are not "commercial" in nature. The state and local governments engage in those activities to promote public interests rather than private profits. Without lotteries, taxes would need to be raised. Without convention centers and hotels, taxes would be lost.

It is far too simplistic to call something "commercial" simply by looking to a set of activities that may look "business-like" or may be performed in the private sector as well.

The final rule must reflect the fact that: (1) generating revenue for public purposes is an essential government function of Indian tribal governments, and (2) when Indian tribal governments engage in business activities to generate public funds they are no more "commercial" than the Minnesota state lottery, the Los Angeles Convention Center or the Port of Seattle.

- ! The final rule should recognize that generating revenue for public purposes is an essential purpose of tribal government;
- ! Tribes should be able to engage in any activity that is similar in purpose, scope or result that state or local governments may engage in to generate public funds without jeopardizing tribal government status; and
- ! The final rule should grant deference to tribal determinations with regard to the essential nature of a government activity and whether or not it is engaged in for commercial or public purposes.

In its current form it is almost impossible for a tribe to satisfy the Proposed Rule. Without significant changes, the PPA provisions intended to clarify government status for tribes will end up extinguishing it by attrition, fear and uncertainty.

2. The "facts and circumstances" test should focus on factors that emphasize the public purpose and use of funds generated, and err in favor of government status.

Essential government function test:

In determining whether an activity is an "essential government function", the rule should defer to goals established by each tribe and the means selected by that tribe to achieve them, as weighed against the backdrop of public policy and self determination set forth in Section II. We suggest the following questions as a framework to begin the facts and circumstances review consistent with the foregoing principals in mind:

1. Whether revenues generated by an activity are used for public versus private purposes?

2. Whether the activity is similar (in purpose, scope, or result) to those performed by other governments?
3. Whether the activity is in furtherance of the tribe's stated goals for self-determination, promoting tribal health, education or welfare, or fostering culture and tradition?
4. Whether the activity is supported by a tribal constitution or other tribal laws?

Commercial activities test:

By implication, the "commercial activities" restriction would come into play only when the activity produces significant revenues. That, however, must be the start of the review, and not the end. In determining whether an activity is "commercial" in nature, we suggest the following additional questions as a framework to begin the facts and circumstances review:

1. Whether revenues from the activity inure to the benefit of the Indian community or to private interests?
2. Whether the activity is in conducted in a manner that is subject to federal income tax or not?
3. Whether the enterprise is designed to provide employment within the tribal reservation or neighboring communities?
4. Whether the enterprise is designed to fill a gap in needed services that private industry has not otherwise stepped in to fill?

The test must err in favor of government status:

One could easily produce a rule sweeping almost any "business" activity into private sector status given the ambiguous terms in the statute and the lack of legislative guidance. The statute could just as well be read narrowly to preserve government status for all but the most "private" of endeavors. Unfortunately, the statutory language is not so easily adapted to anything in between these two extremes.

Given the dilemma created by a parenthetical whose origin and intent is still largely unknown, we urge that the ambiguities be read in favor of tribal sovereignty and government status. It is fundamental that sovereignty waivers must be clear and unequivocal[4]. Regulatory

[4] If a statute affects tribal sovereignty rights or treaty rights, there must be "clear and reliable evidence from the statute or from the legislative history that Congress intended to

discretion is not the place to find that clarity where the legislature itself has failed to speak in an unequivocal fashion.

Until Congress speaks to the issue with clarity, "commercial" activities should be limited to those that are done with a profit motive for private gain. The commercial exception should truly be the exception and not the rule, with deference to tribal government status and sovereignty whenever possible.

A tribal business that is solely owned by a tribal government, whose profits are dedicated to public purposes, and which produces revenue similar to state or local government enterprises should not be treated the same as a "commercial" private enterprise regardless of how "business like" it may appear. State and local governments engage in many activities that could be considered "commercial" in nature. But they remain treated as governmental precisely because they are established to further a government purpose rather than private profit.

Examples reported by the General Accounting Office in 2006 are illustrative:

- From 2000 through 2004, state municipalities issued almost 61 billion dollars in tax exempt bonds for "park and recreation facilities" including theaters, stadiums and arenas.
- There were about 2,400 municipal golf courses reported in 2005, constituting about 15 percent of all golf courses in the United States.
- A significant number of municipal courses were found to have been tied to "resorts or real estate developments".
- More than 300 government owned convention centers and hotels were reported, 11.1 billion dollars of which were identified as having been financed through tax exempt issuances from 2000-2004.
- The GAO report recognized that "all but 2 states have some form of legal gaming [with] 41 states and the District of Columbia providing state lotteries."

Other examples of state and local governments engaging in economic ventures to raise funds for public purposes can be found in almost every community:

- Boat rentals at coastal and lake marinas within state recreation areas and parks;
- Golf at the city owned courses across the country;
- Special events booked at City facilities;
- County and state fairs;

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infringe upon tribal rights". *See Minnesota v. Mille Lacs Band of Chippewa Indians,* 526 U.S. 172, 202 (1999); *see also United States v. Dion,* 476 U.S. 734,739 (1986).

- Football games at public universities and schools that use city and state owned facilities;
- City owned hotel and convention centers;
- Lumber sold from state forest lands;
- State lotteries, state gaming facilities, and state revenue sharing with tribal entities;
- State liquor stores;

All of the above activities could be called "commercial" but for the fact that the revenues they generate inure to the benefit of public rather than private interests.

3. The final rule should reject the Joint Committee examples of Notice 2006-89.

The Proposed Rule continues the artificial categories set forth in Notice 2006-89 as "examples" of commercial activity (casinos, hotels, service stations, convenience stores and marinas) as if they were supported by the force of law or legislative history. They are not. There is no evidence in the statute itself that casinos, hotels, service stations, convenience stores or marinas were intended to be categorically treated as "commercial" activities. There was no floor debate addressing the issue or the categories in Notice 2006-89. Nor did a single bill leading up to the Pension Protection Act contain such examples. These categories were established solely by the Joint Committee on Taxation with no input from tribes and no consultation as required by Executive Order 13175. If states can conduct lotteries to raise public funds without question, the categories set forth in Notice 2006-89 must fall.

We also note the inherent flaw in using any "activity" examples to "deem" commercial status. The examples presume that commercial status can be decided solely by looking at "covered activities" in isolation. However, this is not how distinctions are drawn in real life. There are many for-profit, non-profit, and government status entities that perform the same basic set of activities. For example, public schools and private schools; government hospitals and private hospitals. It is not the "activity" that makes something "commercial" or "governmental" or "public" or "private"; it is the existent of private benefit and profit motive versus public benefit and public service that is key.

4. Treasury and IRS should immediately lift the amendment restrictions of Notice 2007-67.

The original transition relief for tribal plans under the PPA, Notice 2006-89, initially contemplated that tribes would have sufficient guidance to make plan changes by September 30, 2007. When it became clear that guidance would take much longer than that, the transitional relief was extended in Notice 2007-67. Unfortunately, the 2007 extension contained the following amendment restriction:

> "This extension is conditioned on the plans involved not being amended, for periods before the extended date, to reduce benefits unless the reduction: (i) does not vary based upon whether the participant is a governmental ITG employee or a commercial ITG employee, or (ii) is made to the plan for commercial ITG employees and is the minimum reduction necessary to satisfy the requirements of the Code. If a reduction occurs that does not meet either of these conditions, the extension provided under this notice ends on the date the reduction goes into effect."

Not only is this restriction more limiting for tribal governments than for any other government employer, but it is more limiting than the rules that apply to private sector employers. Even private sector employers that are subject to all of the anti-discrimination rules are free to amend and design different plans for different groups or entities with so long as they do not have the effect of impermissible discrimination in favor of highly compensated employees.

During the intervening 6 years of transitional relief without guidance, tribes have had to endure one of the largest economic downturns in U.S. history with their hands tied on benefit changes under the threat of lost government plan status. While one would have hoped this draconian restriction would have been lifted long before the passage of 6 years, the Proposed Rule would actually extend it.

These restrictions were misguided from the start and violate any sense of deference or government-to-government protocol. A restriction that is based on the apparent fear that tribal governments are less fair than other governments is bad enough. But this particular restriction presumes that tribal governments will be less fair than even the most profit minded businessman (who, unlike tribes, has the right to cut back benefits if needed).

There is no evidence that tribal governments are any less fair than other governments when it comes to plan design. And even if tribal governments wanted to provide more lucrative benefits for government workers than for “commercial” workers, such a decision is for the tribal government to make, not the IRS. The IRS does not second guess state and local governments when they elect to pay higher benefits with often corresponding lower wages than the private sector. The IRS does not second guess private employers that make design changes that do not have the effect of impermissible discrimination in favor of highly compensated employees.

There is no justification for the amendment restrictions on tribal plans and they should be eliminated at once.

5. Split employees cannot be required to participate in two plans at the same time.

The Proposed rule purports to require employees with split service between government and commercial entities to split participation between both the tribe's commercial and government plans. This is unworkable and far too costly. Any theoretical benefit to the employee or the perception of promoting IRS or DOL compliance will quickly vanish when, for example, the employee wants to take out a plan loan or make a hardship distribution.

> What balance is available? How are repayments allocated? What if one plan permits an option that the other plan does not offer? What if the employer plans use different administrators who may not coordinate loan processing or repayments with each other? What plan is paid and what plan is defaulted if a payment is not made?

At perhaps twice the cost, many employers may simply eliminate "bells and whistles" that are hard or expensive to administer or to communicate.

The difficulty and burden in maintaining both government status and commercial status plans at the same time is unprecedented. But requiring tribes to waive government status or maintain two types of plans for the same employee at the same time, is wholly unreasonable. The final rule should allow each tribal government to determine a single plan for each of its employee classes based on the majority of duties assigned to that class. The tribal government should not be second guessed on the classification so long as it is done in good faith and pursuant to bona fide needs. Individual work assignments within a class should not be used in isolation to re-characterize an employee otherwise classified by the tribe as a government or commercial status employee.

6. The final guidance must address control group testing <u>before</u> tribes are subjected to private sector rules.

Tribes need to know which of their plans are "commercial" and which are "governmental" in order to determine what rules they need to comply with in order to protect tax benefits provided to their employees. There is little benefit to answering the question until IRS is prepared to inform tribes what rules will actually apply. In fact, many issues will be worse if tribes, for example, are forced to split their plans based on the issuance of a final definition but before there is substantive guidance on how the split plans are to be maintained or administered.

The Proposed Rule does not offer any substantive guidance on compliance issues that tribes will face when attempting to comply with both private sector and public sector rules at the same time. With regard to control group testing, the Proposed Rule simply states as follows:

> "these proposed regulations do not address the rules under which, for purposes of sections 401, 408(k), 408(p), 410, 411, 415 and 416, all employees of all corporations that are members of a controlled group of corporations are treated as employed by a single employer for purposes of these controlled group rules."

We understand the difficulty in providing substantive guidance and why, after six years, there remain more questions than answers. However, it is not acceptable to forge full steam ahead with a rule that would favor more plan splits and more "shared" status employees without addressing the substantive fallout.

The final rule cannot avoid guidance on control group issues and then compound compliance difficulty for tribes by requiring more employees to split between more plans. The fact is that tribal governments are not "corporations." None of the above statutes purport to apply control group testing to tribal governments and there is certainly no legislative history indicating an intent to do so. We would urge IRS simply to confirm that the control group testing requirements do not and will not apply.

- To the extent control group testing is applied to tribal entities, the proposed regulations should expand the Qualified Separate Line of Business testing exceptions to accommodate structure issues unique to tribal governments.
- The new regulations should provide relief to allow for the transfer of employees and benefits among different tribal entities.
- The new guidance should clarify that "commercial" entities may exclude government employees for purposes of coverage and minimum participation tests.

7. Tribes will need guidance on jurisdictional issues directly implicated by the final rule on government and commercial status.

The final rule on commercial status must ultimately be coordinated with the DOL and ERISA. ERISA Section 3(32) was amended under the PPA to include the same government exemption for tribal plans that appears in Code Section 414(d). Because the original tribal

exemption language in the Senate Bill leading up to the PPA (and all prior House bills) contained an absolute exemption on par with state and local governments, there was no need to address how ERISA would apply to tribal plans.

This changed, of course, when the commercial exception was added in conference subjecting tribal plans to ERISA (but no coordinating language outside of the ill thought parenthetical was added). Thus things like qualified domestic relations orders remain defined in ERISA and Code Section 414(p) solely under state domestic relations law (not considering tribes with their own domestic relations laws and codes)[5]. ERISA also purports to convey concurrent jurisdiction over benefit claims in federal and state court. While there is no mention of tribal court jurisdiction, Congress certainly did not intend to subject a tribe to suit by tribal employees in state court.

> The practical impact of this unintended result is disturbing. For example: Two tribal members are married under tribal law and have lived and worked on reservation their entire lives. One works for the tribal government. The other works for a "commercial" enterprise. Should they get divorced, they would now have to go off reservation to state court rather than tribal court to divide their "commercial" pension benefits. Moreover, the division would have to be made pursuant to "state domestic relations law" rather than tribal law, even if they have never lived off reservation and regardless of any difference between the tribal laws and state laws that will be applied. . .

We understand that the guidance to date has been issued only by Treasury and IRS, but we hope the above example demonstrates the need to coordinate certain issues with DOL before binding tribes to a "commercial" definition that may have unintended consequences.

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[5] Code Section 414(p) (which applies to “commercial” plans) restricts the division of pension assets upon divorce to those instances where a qualified domestic relations order (a “QDRO”) is issued. Code Section 414(p)(1)(B) requires such an order to be issued “pursuant to a State domestic relations law”.

8. Administrative Correction Should be Liberally Construed.

The Proposed Rule requests comment on the availability of administrative correction programs for errors related to government status plans. The undersigned contend that administrative relief should be construed liberally in favor of tribal governments consistent with the "government-to-government" relation between the federal and tribal governments.

9. The final rule should reflect recent recommendations from Treasury and the IRS Advisory Committee on Taxation.

The undersigned urge the final rule to reflect recommendations by the IRS Advisory Committee on Taxation to grant relief from PPA requirements pending final guidance, and to exempt tribes from the control group testing requirements. The undersigned also urge the final rule to reflect Treasury's recent report on tax exempt bonds in which it recommends elimination of the essential government function test.

IV. Interim Relief

While the Proposed Rule is being considered, we urge IRS and Treasury to modify the PPA transitional relief currently set forth in Notice 2006-89 and 2007-67. The transitional relief should eliminate the amendment restrictions noted above, and abandon the Joint Committee presumptive "commercial" categories in favor of a good faith standard based on the factors set forth in Section III (1 and 2). Transition relief based on the foregoing would comport with the policies and canons of construction set forth in Section II and provide a base point for evaluating the impact of actual tribal decisions made under deference and in good faith.

The interim relief should be from all compliance amendments, reporting requirements (5500s), control group testing, 401(b) remedial amendment relief and other amendment deadlines pending the issuance of final guidance under the PPA. Tribes should be afforded a good faith standard with no design restrictions or artificial categories for presuming commercial status.

V. Suggestions for Process and the Form Guidance Should Take

We appreciate the willingness of IRS to put this issue on its agenda of administrative guidance priorities. We particularly appreciate that it has done so in a way that provides for

meaningful input from tribal elected leaders, staff and advisors. In this regard, we emphasize the following points that may improve process and produce a more meaningful form of guidance:

(1) Extended Period for Genuine Consultation

We urge Treasury and IRS to consider an extended period of consultation to ensure notice and opportunity for input from tribes across all regions. Organizations such as NCAI, NAFOA, CATG, ATNI and USET can assist in providing notice to members of developments and opportunities for input as the process moves forward. We encourage the IRS to keep the organizations informed of progress and we will continue to solicit input from our collective memberships.

Throughout the guidance project, we urge continued consultation with tribes and incorporation of their input into the final product. There are over 500 recognized tribes, with diverse histories, needs, and policy approaches. Consultation requires *meaningful* input from tribes and a true "seat at the table" as the rules are developed. Guidance on this critical tax doctrine should be developed in a true collaborative process. "Listening" group meetings followed by published guidance will not provide the collaboration needed to make this guidance a success. We also believe that it will take an extended period of time to secure input from the many tribes and tribal programs impacted by the guidance project.

(2) Establishment of an Advisory Work Group

Some of our members have suggested that the IRS and Treasury work with us to form an "Advisory Work Group" on key IRS and Treasury guidance projects such as the PPA and the General Welfare Exemption. As noted in our recent comments on the GWE and again below in the background section for each organization contributing to these comments, NCAI, NAFOA, USET, ATNI and CATG, in combination, include members from most Indian tribes throughout the country. The organizations also have access to tax practitioners who work with these tribes, and the organizations have developed a joint task force on taxation that is equipped to coordinate and provide input on tax policy matters such as the PPA and GWE.

(3) Circulation of an Additional ANPRM

We commend IRS and Treasury for initiating this project with an advance notice of proposed rule making ("ANPRM"). We think that this is a helpful means to foster discussion while the consultation process can proceed. We think it would be helpful for the next draft to again be issued in this form with the benefit of the comments that have been solicited during this initial phase of the guidance project.

We also urge Treasury and the IRS to include a preamble or other communication responsive to the comments received so that the next guidance reflects the considerations given to specific tribal concerns.

VI. Membership and Representation Within the Contributing Organizations

The National Congress of American Indians, the Native American Finance Officers Association, the United South and Eastern Tribes, the Affiliated Tribes of Northwest Indians, and the California Association of Tribal Governments, in combination, represent tribes and tribal entities in all regions throughout the country. The Joint Comments reflect input solicited by all organizations through various means including member communications and meetings, and joint taxation taskforce meetings with tribal and tribal representative participation. The organizations and their members also have participated in the consultation meetings conducted by IRS and Treasury on this topic.

The organizations reserve the option to present oral testimony at any hearings on the PPA and to secure testimony from their member tribes.