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#6**INDIAN TRIBAL GOVERNMENTS (ITGs): Treat ITGs As States for Social Security Tax Purposes****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to a Fair and Just Tax System*

**PROBLEM**

Indian Tribal Governments (ITGs) have a unique status for federal tax purposes.<sup>2</sup> In 1983, Congress enacted Internal Revenue Code (IRC) § 7871 which provides that ITGs are treated as States for certain tax purposes,<sup>3</sup> acknowledging that, in many respects, ITGs function like States and should therefore be treated as such.<sup>4</sup> More recently, in 2000, Congress decided that ITGs should be treated identically to States with regard to Federal Unemployment Tax Act (FUTA) taxes, allowing ITGs, like State governments, to elect to pay FUTA taxes only when a former employee claims unemployment benefits.<sup>5</sup> However, ITGs are not treated as States for the purpose of Social Security taxes. Thus, unlike State employees, ITG employees who are covered by a State retirement plan are not excepted from Social Security taxes.<sup>6</sup> This inconsistency creates compliance burdens for ITGs and their employees.

In addition, as the law currently stands, ITGs may not be able to recruit and retain tribal police officers by offering participation in favorable State pension plans. Because ITGs are not treated as States for Social Security taxes under IRC § 7871 or any other IRC provision, ITGs and tribal police officers who participate in a State pension plan are still responsible for their respective employer and employee portions of Social Security tax. This creates an inequity that can impede the ITG's ability to recruit and retain police officers, places an economic burden on the ITG attempting to address crime on tribal lands, and thereby frustrates congressional intent to deal with this issue.<sup>7</sup> It also undermines ITG taxpayers' *right to a fair and just tax system*.

1 See Taxpayer Bill of Rights, available at [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

2 For a discussion of the various federal tax provisions applicable to ITGs, see Joint Committee on Taxation, *Overview of Federal Tax Provision and Analysis of Selected Issues Relating to Native American Tribes and Their Members*, JCX-40-12 (May 14, 2012).

3 See IRC § 7871(a). These include the ability to receive tax deductible charitable contributions for income, estate, and gift tax purposes, the special treatment afforded to States for certain excise taxes, the ability to deduct taxes paid to an ITG, and the issuance of tax-exempt government bonds. ITGs are also treated as States for other purposes that are set forth in IRC § 7871(a).

4 This section was originally enacted by the Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, § 202(a), 96 Stat. 2605, 2608-11 (1983). It has been amended several times since the initial enactment.

5 See Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 166, 114 Stat. 2763, 2763A-627 (2000). This legislation amended FUTA provisions contained in IRC §§ 3306 and 3309 to provide that ITGs are to be treated like State and local governments for FUTA purposes. See IRC §§ 3306(c), 3306(u), and 3309. See also Announcement 2001-16, 2001-1 C.B. 715 (providing guidance to ITGs on FUTA obligations).

6 IRC § 3121(b)(7)(F).

7 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202, 124 Stat. 2261, 2262 (2010) (noting that domestic and sexual violence against American Indian and Alaska Native women has reached epidemic proportions and that Indian tribes have experienced significant increases in domestic violence, burglary, assault, and child abuse on Indian reservations). See also Timothy Williams, *Higher Crime, Fewer Charges on Indian Land*, N.Y. TIMES, Feb. 20, 2012, available at [http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?\\_r=0](http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?_r=0) (citing Department of Justice (DOJ) data that the country's 310 Indian reservations have violent crime rates that are more than two and a half times higher than the national average).

## EXAMPLE

An ITG is facing an increase in crime on its land. To deal with this increase, the tribe seeks to recruit additional police officers and is also concerned about the retention of its current police officers. The tribe is located within a State that, to incentivize the recruitment and retention of qualified police officers, offers a retirement plan with excellent benefits to State police officers. Under IRC § 3121(b)(7)(F), State police officers who are covered by this retirement plan are excepted from paying Social Security taxes.

To facilitate recruitment and retention of police officers, the tribe has entered into an agreement with the State that permits police officers employed by the tribe to participate in the State's retirement plan. However, because tribal police officers are technically employees of the tribe and not the State, they are not excepted from Social Security taxes. Therefore, if they wish to participate in the State retirement plan, the tribal police officers and the ITG must pay into both Social Security and the State retirement system. This inconsistent treatment between State and tribal police officers has an adverse effect on the tribe's ability to recruit and retain tribal police officers and places an economic burden on the tribe, which is attempting to address the increase in crime on tribal lands.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as a "State."

## PRESENT LAW

The Federal Insurance Contributions Act (FICA) provisions in the IRC provide for Social Security taxes (also referred to as old age, survivors, and disability insurance, or OASDI) on both employers and employees.<sup>8</sup> IRC § 3101(a) imposes on the income of every individual a 6.2 percent Social Security tax on the wages (as defined in IRC § 3121(a)) received with respect to employment (as defined in IRC § 3121(b)). IRC § 3111(a) imposes on every employer, with respect to having individuals in its employ, a 6.2 percent Social Security excise tax on wages (as defined in IRC § 3121(b)).

IRC § 3121(b)(7)(F) provides an exception to the term "employment" for Social Security tax purposes and states that services performed in the employ of a State, or any political subdivision thereof, or any instrumentality, are not subject to Social Security taxes. However, this exception does not apply unless the employee is covered by a retirement plan of the State, political subdivision, or instrumentality.

IRC § 7871(a) provides that ITGs shall be treated as States for certain purposes enumerated in this section. However, this section does not provide that ITGs should be treated as States for the purpose of Social Security taxes.

## REASONS FOR CHANGE

In previous Annual Reports to Congress, the National Taxpayer Advocate has written about the unique needs of ITG taxpayers as well as made a legislative recommendation to treat ITGs as States for the

<sup>8</sup> The FICA provisions are contained in Subtitle C, Chapter 21 of the IRC. FICA taxes also include Medicare taxes (also called hospital insurance, or HI) and the Additional Medicare tax, but these are not at issue here.

purpose of the adoption credit in IRC § 23.<sup>9</sup> ITGs have a unique status for federal tax purposes.<sup>10</sup> IRC § 7871 provides that ITGs are treated as States for certain tax purposes set forth in that section.<sup>11</sup> These include the ability to receive tax deductible charitable contributions for income, estate, and gift tax purposes,<sup>12</sup> the special treatment afforded to States for certain excise taxes,<sup>13</sup> the ability to deduct taxes paid to an ITG,<sup>14</sup> and the issuance of tax-exempt government bonds.<sup>15</sup> In the legislative history of IRC § 7871, a report of the Senate Committee on Finance provides the reason that Congress chose to treat ITGs as States for certain purposes. It states:

Many Indian tribal governments exercise sovereign powers; often this fact has been recognized by the United States by treaty. With the power to tax, the power of eminent domain, and police powers, many Indian tribal governments have responsibilities and needs quite similar to those of State and local governments. Increasingly, Indian Tribal governments have sought funds with which they could assist their people by stimulating their tribal economies and by providing governmental services. The committee has concluded that, in order to facilitate these efforts of the Indian tribal governments that exercise such sovereign powers, it is appropriate to provide these governments with a status under the Internal Revenue Code similar to what is now provided for the governments of the States of the United States.<sup>16</sup>

Thus, in enacting IRC § 7871, Congress acknowledged that, in many respects, ITGs function like States and should therefore be treated like them for certain federal tax purposes.

More recently, in 2000, Congress decided that ITGs should be treated as States with regard to FUTA taxes.<sup>17</sup> Under FUTA, employers must pay a six percent tax on total wages paid with respect to covered employment.<sup>18</sup> The change in law allowed ITGs, like State governments, to elect to pay FUTA taxes only when a former employee claims unemployment benefits.<sup>19</sup> Therefore, for FUTA tax purposes, ITGs are treated identically to States.

Regarding Social Security taxes under FICA, in 1990, Congress was concerned about State and local government employees who were neither covered by a State retirement system or through the federal Social

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- 9 See National Taxpayer Advocate 2013 Annual Report to Congress 116 (Most Serious Problem: *Indian Tribal Taxpayers: Inadequate Consideration of Their Unique Needs Causes Burdens*); National Taxpayer Advocate 2012 Annual Report to Congress 521 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).
- 10 For a discussion of the various federal tax provisions applicable to ITGs, see Joint Committee on Taxation, *Overview of Federal Tax Provision and Analysis of Selected Issues Relating to Native American Tribes and Their Members*, JCX-40-12 (May 14, 2012).
- 11 This section was originally enacted by the Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, § 202(a), 96 Stat. 2605, 2608-11 (1983). It has been amended a few times since the initial enactment.
- 12 IRC § 7871(a)(1).
- 13 IRC § 7871(a)(2).
- 14 IRC § 7871(a)(3).
- 15 IRC § 7871(a)(4). ITGs are also treated as States for other purposes that are set forth in IRC § 7871(a).
- 16 S. REP. No. 97-646, at 11 (1982).
- 17 See Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 166, 114 Stat. 2763, 2763A-627 (2000). This legislation amended FUTA provisions contained in IRC §§ 3306 and 3309 to provide that ITGs are to be treated like State and local governments for FUTA purposes. See IRC §§ 3306(c), 3306(u), and 3309. See also Announcement 2001-16, 2001-1 C.B. 715 (providing guidance to tribes on FUTA obligations).
- 18 The FUTA provisions are contained in IRC §§ 3301-3311.
- 19 IRC § 3309(d).

Security program.<sup>20</sup> It therefore enacted legislation to require Social Security coverage for State or local government employees who were not covered by a retirement system in conjunction with their employment.<sup>21</sup> However, Congress provided a Social Security tax coverage exception for State employees who are actually covered (*i.e.*, not simply eligible to participate) by a State retirement plan.<sup>22</sup>

When enacting IRC § 7871 in 1983, Congress recognized the unique attributes of ITGs and how they have similar needs and characteristics as States and should therefore be treated as States for many tax purposes. Similarly, in 2000, Congress decided to treat ITGs as States for FUTA tax purposes.

ITGs face high levels of crime, particularly violent crime, on tribal lands.<sup>23</sup> In response, Congress enacted the Tribal Law and Order Act of 2010 to encourage the hiring of more law enforcement officers for Indian tribal lands and provide additional tools to address critical public safety needs.<sup>24</sup> Specifically, one of the purposes of this legislation was “to empower tribal governments with the authority, resources, and information necessary to safely and effectively provide public safety in Indian country.”<sup>25</sup> This law also, among other things, expands efforts to recruit, train, and retain tribal police officers.<sup>26</sup>

An ITG grappling with a surge in crime will naturally seek to recruit additional tribal police officers and do its best to retain its current ones. To facilitate recruitment and retention, an ITG will likely attempt to put forth attractive compensation packages for tribal police officers, including offering favorable retirement benefits. Due to complex jurisdictional issues on Indian tribal lands, an ITG will often enter into agreements with State (and federal) authorities to coordinate law enforcement efforts.<sup>27</sup> An ITG may also enter into an agreement with a State in which it is located to allow tribal police officers to participate in the State’s retirement plan.

However, if tribal police officers choose to participate in a State retirement plan, they and the ITG must still pay Social Security taxes in addition to any contributions they make to the retirement plan. Yet, as State employees, their State police officer counterparts are excepted under the IRC from Social Security taxes if they participate in a State retirement plan.<sup>28</sup> This places an unfair economic burden on ITGs and is a disincentive for tribal police officers to work on Indian tribal lands. As a result, ITGs may not be able to recruit and retain tribal police officers by offering participation in favorable pension plans.

20 See Staff of H. Comm. of Ways and Means, 101st Cong., Legislative History of Ways and Means Democratic Alternative, Ways and Means Comm. Print No. 101-37, at 86-87 (1990).

21 See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, Title XI, § 11332(b), 104 Stat. 1388, 1388-469 (1990).

22 See IRC § 3121(b)(7)(F).

23 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202, 124 Stat. 2261, 2262 (2010) (noting that domestic and sexual violence against American Indian and Alaska Native women has reached epidemic proportions and that Indian tribes have experienced significant increases in domestic violence, burglary, assault, and child abuse on Indian reservations); see also, *e.g.*, Timothy Williams, *Higher Crime, Fewer Charges on Indian Land*, N.Y. TIMES, Feb. 20, 2012, available at [http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?\\_r=0](http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?_r=0) (citing DOJ data that the country’s 310 Indian reservations have violent crime rates that are more than two and a half times higher than the national average).

24 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 201, 124 Stat. 2261 (2010). See also DOJ, *Tribal Law and Order Act*, available at <http://www.justice.gov/tribal/tribal-law-and-order-act>.

25 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202(b)(3), 124 Stat. 2261, 2263 (2010).

26 See DOJ, *Tribal Law and Order Act*, available at <http://www.justice.gov/tribal/tribal-law-and-order-act>.

27 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202(a)(4)(C), 124 Stat. 2261, 2262 (2010) (noting that the complicated jurisdictional scheme in Indian country requires a high degree of commitment and cooperation among tribal, federal, and State law enforcement officials).

28 See IRC § 3121(b)(7)(F).

More importantly, the inconsistency in tax treatment of ITGs and tribal police officers for Social Security tax purposes as compared to their counterparts employed by States appears to run contrary to congressional intent in reducing crime, particularly violent crime, on Indian lands.

To address this inequity and the compliance burdens placed on ITGs and tribal officers (and other ITG employees), to provide uniform treatment of ITGs as States for all employment tax purposes, and to comport with congressional intent in addressing crime on ITG lands, Congress should amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as a State. This would mean that ITG police officers who participate in a State retirement plan, as well as the ITG, would not be responsible for Social Security taxes. In making this legislative change, Congress can align both tax and non-tax legislation impacting ITGs.

### EXPLANATION OF RECOMMENDATION

The proposal to amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as States would allow ITGs to better recruit and retain tribal police officers to address crime on Indian tribal lands, which has been a goal of Congress in non-tax legislation.<sup>29</sup> This proposal would provide parity between ITG and State law enforcement officers and would also be in line with prior congressional action treating ITGs as States for IRC § 7871 and FUTA purposes. This change would also protect the fundamental taxpayer *right to a fair and just tax system*.

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<sup>29</sup> Technically speaking, this proposal would amend IRC § 7871(a) to include a provision similar to IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as States. Simply treating ITGs as a State under IRC § 3121(b)(7)(F) would not achieve the desired result because the tribal police officer or other ITG employee would not be participating in an ITG retirement plan but rather a State retirement plan. However, the goal of this proposal is to extend the benefits of IRC § 3121(b)(7)(F) to ITG employees, particularly ITG tribal police officers, who participate in a State retirement plan.