



## How to Claim Tax-Free Tribal Benefits From IRS

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On June 3, 2014 the Internal Revenue Service issued Revenue Procedure 2014-35, *Application of the General Welfare Exclusion to Indian Tribal Government Programs That Provide Benefits to Tribal Members*. The application of the general welfare exclusion (or “GWE”) to tribal government programs has been a subject of active tribal engagement for several years. Tribes and tribal organizations have demanded that the IRS consistently and clearly establish that the program benefits tribal governments provide to their members for the welfare of the tribal community are not subject to tax. In response, Rev. Proc. 2014-35 sets forth guidelines intended to limit the discretion of IRS agents and to provide flexibility and certainty to tribes that their general welfare program benefits will not be taxable to recipients.



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The Revenue Procedure reaffirms that the IRS's longstanding general welfare exclusion "applies to payments by Indian tribal governments no less favorably than it applies to payments by federal, state, local, or foreign governments." Generally, payments made by any government for the general welfare are not taxable to the recipients of such benefit payments if those payments are: (1) made pursuant to a governmental program; (2) for the promotion of the general welfare (based on individual or family need); and (3) not compensation for services.

In recognition of the unique legal status of tribes, the IRS has confirmed that the general welfare exclusion may also apply differently to tribal government programs than to other governments. Rev. Proc. 2014-35 explains that "Indian tribal governments have developed a broad range of programs to address their unique social, cultural and economic needs." In administering

programs to promote the general welfare, tribal governments consider not only individual and family need but also "the needs of the entire community." IRS acknowledgment of tribal communal needs clarifies and affirms that tribal governments may develop customized general welfare programs tailored to community needs will not be subject to taxation. For example, the Revenue Procedure points to a 1977 Revenue Ruling affirming that loans provided by a tribal government to its members to "establish Indian owned economic enterprises on or near a reservation" qualified for the general welfare exclusion as its served the community need for employment opportunities.

Throughout the consultation on the GWE guidance, tribes insisted upon certainty and demanded the elimination of subjective IRS agent determinations in the administration of the GWE. The Revenue Procedure establishes two sets of "safe harbor" rules that may be used by tribes to accomplish these objectives. Under the safe harbor rules, the IRS will (1) "conclusively presume" that the need criterion under the GWE is met for payments made pursuant to certain tribal government programs; and (2) "conclusively presume" that certain payments (related to cultural programs services) are not taxable as compensation for services. The safe harbor rules complement and are in addition to Rev. Proc. 2014-35's clarification of the application of the GWE doctrine to Indian tribal governments as discussed above.

To qualify for the first safe harbor under which the IRS will conclusively presume need, a tribal program must be structured to meet two requirements: (a) it complies with the rule's six criteria, including having written guidelines; and (b) it falls within one of the five broad program areas – housing, education, culture and religion, elder and disabled assistance, or other specified assistance programs. Tribal program benefits meeting these requirements will be conclusively presumed to meet the GWE need requirement and be deemed nontaxable. This safe harbor rule offers tribes and recipients of tribal program benefits an added degree of certainty in tax administration. Importantly it does not limit tribes from providing other general welfare program benefits which would also be nontaxable if those programs are administered according to the longstanding GWE rule: (1) made pursuant to a governmental program; (2) for the promotion of the general welfare (based on individual, family, or community need); and (3) not compensation for services.



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Flexibility is a key feature of the new Revenue Procedure. The final version of the guidance modifies and broadens the scope of the program activities eligible for the safe harbor GWE treatment compared to the IRS GWE draft rule issued in 2012. It is now established that GWE treatment under those listed program activities are “illustrative only rather than an exhaustive list.” Additionally, the revised list of specific GWE eligible benefits repeatedly uses the term "including but not limited to" which requires IRS deference to tribal government determinations as to how they choose to administer their general welfare program benefits.

The second safe harbor applies to “payments” by tribes to cultural or spiritual leaders in honor of their participation in cultural, religious, or ceremonial events. The second safe harbor will conclusively conclude that such payments, when not lavish or extravagant under the facts and circumstances, provide for a tribal community need and not as taxable compensation.

There are actions that tribes should consider taking to ensure that a benefit paid to "any tribal member" or other "qualified nonmembers...who satisfy program guidelines" is determined to be non-taxable. First, in order to take full advantage of safe harbor treatment, tribal governments must have written guidelines in place. As the first safe harbor rule requires the tribe's guidelines, procedures and eligibility rules to be spelled out in writing, if a tribe does not have written guidelines in place for all of its general welfare programs or its' existing guidelines need to be updated or revised – the issuance of Rev. Proc. 2014-35 provides reason to do so. Tribes will also want to carefully review the recordkeeping and administering procedures surrounding all their general welfare programs, and consider creating, reviewing, or improving any existing guidelines for their general welfare programs. Clear and concise written guidelines will protect tribal benefit programs from the possible inconsistent application of the GWE by an over-zealous IRS agent.

Rev. Proc. 2014-35 also requires tribal governments (and benefit recipients) to be able to substantiate and document non-taxable benefits made pursuant to general welfare programs. The Revenue Procedure states that in order to prove that a payment qualifies for the GWE both payors and recipients must maintain books or records for all payments to which the tribe asserts the GWE is applicable.

The final revenue procedure applies to benefits "provided on or after December 6, 2012", and it may also be applied retroactively for claims of overpayment of taxes in prior years.

Rev. Proc. 2014-35 represents an important opportunity for tribal governments to ensure that the general welfare program benefits they provide to members and qualified nonmembers are not taxable.

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