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The Internal Revenue Service Issues Important Final Guidance on the Application of the General Welfare Exclusion to Certain Tribal Government Programs

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I. Introduction

As a result of a recent IRS ruling, Native American Governments could be exposing its tribal members to the risk of potential and unnecessary taxable personal income which otherwise could be excluded, and could be exposing the Tribal Government to penalties for failing to properly treat such benefits for tax purposes. In light of the Ruling, Tribes should consider amending the terms of their welfare programs as soon as possible to avoid these risks.

On June 4, 2014, the Internal Revenue Service ("IRS") issued Revenue Procedure 2014-35, entitled "Application of the General Welfare Exclusion to Indian Tribal Government Programs that Provide Benefits to Tribal Members" (the "**Revenue Procedure**"). The Revenue Procedure supersedes the IRS's earlier guidance in Notice 2012-75, and describes principles of the General Welfare Exclusion (the "**GW Exclusion**"), as well as providing safe harbors under which the IRS will conclusively presume that the "individual need requirement" of the GW Exclusion is met for benefits provided under certain Indian tribal governmental programs described in the Revenue Procedure (the "**Safe Harbors**"). If such Safe Harbors are met for the certain Indian tribal governmental program, the IRS will not assert that such benefits provided under such programs are taxable gross income to a tribal member who benefits from such program.

This Alert: (i) provides historical background regarding the GW Exclusion in general; (ii) describes in more detail the importance of the GW Exclusion to Indian tribes and its members; (iii) provides a list of requirements that must be met in order for a tribal program to satisfy the Safe Harbor and be treated as eligible for the GW Exclusion; (iv) provides a list of the various tribal programs covered by the Revenue Procedure; and (v) provides action steps to be taken by Indian tribal governments ("**Tribes**") at this time.

II. The General Welfare Doctrine or Exclusion (GW Exclusion) – In General

The GW Exclusion is an IRS administrative rule that operates to exclude certain social benefit program payments from the taxable gross income of a tribal member. To qualify under the GW Exclusion, payments must:

- 1) be made pursuant to a governmental program;
- 2) be for the promotion of the general welfare (based on the individual financial need of the recipient)(the "**Individual Need Requirement**"); and

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- 3) not represent compensation for services.

Generally, grants received under social welfare programs that do not require recipients to establish individual need do not qualify for the GW Exclusion. Included within the definition of “government” are Indian tribal governments, as well as federal, state, local, and foreign governments.

Examples of excludable benefits include disaster relief, adoption assistance, housing and utility subsidies for low income persons, and government payments made to the blind.

III. Issues Relating to Application of GW Exclusion to Tribes and Tribal Members.

There is some uncertainty concerning the application of the GW Exclusion to certain benefits provided by Tribes to its tribal members. Benefits that have been scrutinized by the IRS include payments for housing, cultural, education, and elder programs provided by the Tribes. The real issue has been whether the tribes can provide such benefits without considering the financial need of the particular tribal member.

IV. Safe Harbor Requirements.

The Revenue Procedure provides safe harbors under which the IRS will presume that the tribal member met the “individual need requirement” required by the GW Exclusion.

To qualify for the safe harbor exclusion, the following general requirements must be met (the “Safe Harbor Requirements”):

- 1) The benefit must be provided pursuant to a specific Indian tribal government program;
- 2) The program has must have written guidelines that specify how individuals may qualify for the benefit;
- 3) The benefit is available to any tribal member or qualified nonmember who satisfies the program guidelines (and the Revenue Procedure clarifies that this requirement will be satisfied if the particular program is available only for an identified group of tribal members or qualified nonmember (*e.g.*, veterans) or if budgetary restraints prevent serving everyone who otherwise satisfies the program guidelines);
- 4) The distribution of benefits from the program does not discriminate in favor of members of the governing body of the tribe;
- 5) The benefit is not compensation for services; and
- 6) The benefit is not lavish or extravagant based on the facts and circumstances.¹

V. Type of Programs Addressed by the Revenue Procedure.

The specific programs to be covered under a Revenue Procedure include: 1) Housing Programs; 2) Educational Programs; 3) Elder and Disable Programs; 4) Cultural and Religious Programs; and 5) other qualifying assistance programs,” including transportation and emergency situations.²

Generally, if the Safe Harbor Requirements are properly met, the IRS will conclusively presume that the Individual Need Requirement is met as it relates to the above type of programs covered by the Revenue Procedure.

¹ Rev. Proc. 2014-35, Section 5.02(1).

² Rev. Proc. 2012-75, Section 5.02(2).

VI. Action Steps.

Tribes should review their tribal programs to ensure that the tribal programs covered by the Revenue Procedure meet the particular Safe Harbor Requirements contained in the Revenue Procedure. If the particular program does not meet the Safe Harbor Requirements, the Tribe should consider amending the terms of such program as soon as possible. Otherwise, the Tribe could be exposing its tribal members to the risk of potential and unnecessary taxable income which otherwise could be excluded, as well as expose the Tribe to penalties for failing to properly treat such benefits for tax purposes.

Eric D. Swenson's practice encompasses both tax controversy and tax planning. Mr. Swenson has represented corporations, partnerships, nonprofits, and individuals in federal, state, and local tax disputes including audits, appeals, and litigation before and against the Internal Revenue Service, CA Franchise Tax Board, CA Employment Development Department, CA Board of Equalization, San Diego County Assessor, and other state taxing authorities.

Theodore J. Griswold is head of the Native American Law practice group and a member of the firm's Clean Tech, Energy, Environmental and Resources practice group. His practice emphasizes natural resource, Native American, wetlands, habitat, and environmental land use matters. He represents Native American governments in Tribal land issues including land and natural resource planning, Tribal property clean-up, federal permitting, water supply development and protection, water quality, and environmental land use issues. Mr. Griswold's practice also includes intergovernmental agreements with state and federal agencies, intergovernmental relations, Tribal land acquisitions and fee-to-trust transfers, protection of Native American Sacred Sites, and Reservation boundary defense. He is working with Tribal members in retaining the value of cultural museum exhibitions and the unauthorized use of allotted lands in public domain situations. He assists Tribal Government in infrastructure grant implementation, Tribal housing permitting and economic development strategies and Tribal leases and economic development projects. Mr. Griswold also acts as pro bono counsel for the Native American Environmental Protection Coalition and Mataam Naka Shin and pro bono co-counsel for California Indian Legal Services' indigent clients.