IRS Interim Guidance Still Leaves HEARTH Act Tribes Out in the Cold

The following is a call for inter-tribal collaboration and agency consultation on an issue of concern to all Tribes that have elected under the HEARTH Act to regulate their own leases of trust land.¹ For more information, please contact Pete Hahn, Treasurer, Seminole Tribe of Florida, at (954) 931-2215 or PeteHahn@semtribe.com.

IRS Interim Guidance

In June 2016, the IRS released an internal memo dated May 26, 2016 entitled “Interim Guidance on the Direct Pay of Tribal Lease Funds.” By issuing the Interim Guidance, the IRS made good on a pledge by IRS Director Christie Jacobs to clarify the tax treatment of BIA-approved leases of tribal trust land set up as direct-pay leases. BIA has long encouraged tribes to set up leases as “direct-pay” so that tribes themselves could more efficiently monitor and collect the rents due to them. However, under regulations also promulgated by Department of Interior (DOI), the Office of Special Trustee (OST) cannot “accept” direct-pay lease funds into an OST tribal trust account. See 25 CFR 115.805. Since prior IRS guidance on the Per Capita Act only addressed distributions of tribal trust revenues made out of an OST trust account, tribes with direct-pay lease arrangements expressed concern that they would need to modify all of their lease arrangements to take advantage of the federal and state tax exemptions under the Per Capita Act as clarified by IRS Notice 2015-67.

The Interim Guidance instructs IRS agents: “Don’t seek information reporting on per capita distributions of direct pay lease funds that, if paid from the [OST] trust [account] would satisfy Notice 2015-67.” By doing so, it implies that such distributions will be treated the same as distributions from an agency-pay lease deposited in a trust account (i.e., not reportable on a 1099 by the tribe and not subject to tax when received by the member).

The Interim IRS Guidance represents a significant step in the right direction, but it is too limited. The stated rationale for the rule change in the Interim Guidance suggests that it only applies to BIA-approved leases, not leases approved by tribes under HEARTH Act leasing authority. Specifically, the memo notes that such “direct pay leases and contracts are approved by the same process or are subject to the same BIA-approved standards as leases and contracts under which the funds are deposited into tribal trust accounts.” While one could argue that HEARTH Act leases are also approved by a similar process and subject to the same or similar standards, the Interim Guidance does not clearly state how direct pay leases approved pursuant to a tribe’s DOI-approved HEARTH Act ordinance will be treated. It is our understanding that IRS is committed to addressing this issue in the near future.

We believe that IRS’ willingness to address the application of its guidance to direct-pay leases negotiated and approved by HEARTH Act tribes would be furthered by consultation with all

¹ The Helping Expedite and Advance Responsible Tribal Home Ownership Act of 2012 (the HEARTH Act) creates a voluntary, alternative land leasing process available to tribes by amending the Indian Long-Term Leasing Act of 1955, 25 U.S.C. Sec. 415. Under the Act, once their governing tribal leasing regulations have been submitted to, and approved by, the Secretary of the Interior, tribes are authorized to negotiate and enter into leases without further approvals by the Secretary. Specifically, the Act authorizes tribes to execute agricultural and business leases of tribal trust lands for a primary term of 25 years and up to two renewal terms of 25 years each. Leases of tribal trust lands for residential, recreational, religious or educational purposes may be executed for a primary term of up to 75 years. In support of tribal self-determination, the Act requires the Secretary to approve tribal leasing regulations if the regulations are consistent with the Department of the Interior’s leasing regulations at 25 CFR Part 162 and they provide for an environmental review process that meets requirements set forth in the Act.
affected tribes—both those tribes that have already received DOI approval of their leasing ordinances, and those in the process of doing so.

**Why IRS Guidance Needs to Go One Step Further**

There are several reasons why we believe that IRS guidance needs to go one step further and provide clear procedures for handling distributions from direct-pay HEARTH Act leases.

- First, any failure to do so undermines the principles of tribal self-determination contained in the HEARTH Act. In some cases, it will force tribes to do the very thing that the HEARTH Act was passed to eliminate—i.e., obtain BIA approval of every lease.

- Second, BIA lacks clear procedures (and the resources) for converting HEARTH Act direct-pay leases into agency pay arrangements.

Through a dialogue with OST, we learned that the Solicitor’s Office believes that HEARTH Act leases “may” be converted from direct-pay arrangements to agency-pay arrangements. But the process will not be easy. According to a February 2016 Solicitor’s Opinion recently shared with us, it will require that each HEARTH Act lease be “reviewed individually [by the BIA] in order to provide an answer to whether the revenue generated by the lease is considered to be a source of money that will be accepted for deposit into a trust account as stipulated in the applicable regulation [citing 25 C.F.R. 115.702].” Then after determining that the source of the lease or contract revenue conforms to the regulations, BIA must decide on “the extent to which the BIA will choose to be involved” in any agency-pay arrangement. Specifically, the Opinion states as follows:

> The [HEARTH Act] Tribe may request the assistance of the BIA in collecting the pay from the Tribe’s lessees. However, the extent to which the BIA will choose to be involved will be determined by the BIA. The BIA has the discretion to decline to administer an agency pay arrangement.

Assuming that BIA decides that it will exercise its discretion favorably, a HEARTH Act tribe will then need to (1) seek tribal governing body approval to modify each direct-pay lease, (2) secure each lessee’s agreement to modify its payment arrangements, and (3) execute the lease amendment in accordance with its Leasing Ordinance and the terms of the Lease Agreement. Thereafter, the HEARTH Act lease payments will be paid directly into an OST account. As a result, HEARTH Act tribes will be able to achieve favorable tax treatment, but having to modify each lease into an “agency-pay” arrangement will make it for difficult for HEARTH Act tribes to monitor and remediate any late payments, non-payments and partial payments of its numerous lessees.

**Increasing Burden on BIA and OST and Undermining Tribal Self-Determination**

Besides imposing formidable compliance burdens on HEARTH Act tribes, converting HEARTH Act direct pay leases to agency pay arrangements impose significant administrative burdens on BIA and OST at a time when the agency’s resources to take on new challenges, tasks and duties are shrinking. In fact, Congress has recently made it clear that OST’s current role is under review, and it has directed the Department of Interior to prepare a report, including transition plan for OST to terminate as a separate entity within 2 years after the report is submitted. See Indian Trust Asset Reform Act, Pub. L. 114-178. Title III. Thus, insisting that HEARTH Act lessors have each lease reviewed by BIA so that they can convert their leases into
agency pay arrangements for deposit into an OST Trust Account makes no sense in the current environment. Further, we would question the capability of BIA to review each HEARTH lease in the manner apparently contemplated by the BIA’s Solicitor’s Office.

We would like to encourage tribal consultation on this issue. To get the ball rolling, here is one suggestion for consideration of both tribal government and federal agency stakeholders, including Treasury and IRS, as well as the BIA and OST.

**IRS Guidance Could Spell Out Procedures for HEARTH Act Tribes to Follow**

A Revenue Procedure (or other form of administrative guidance) could be utilized to spell out the procedures that HEARTH Act tribes could make part of their Leasing Ordinance (or other tribal laws) in order to demonstrate their compliance with the regulatory standards applicable to distributions under the Per Capita Act, the IRS Notice and the recently issued Interim Guidance. Such procedures could reasonably include:

- Identification in the lease or written agreement that the source of the revenues are from the use of tribal trust land or restricted fee land, or from trust resources within the meaning of 25 CFR 115.702.

- If it is not completely clear that the revenues are from trust land or trust resources based on the lease or agreement, the Tribe could secure a reasoned legal opinion (setting forth relevant facts and circumstances, as well as applicable legal authority) that the income is derived from the use of trust land or trust resources.

- HEARTH Act tribes could also agree to segregate revenues that are directly derived from trust lands or trust resources into a special tribal trust fund or account that would not be commingled in any way with other tribal revenues prior to distributions to members. If necessary, tribal CFOs could certify that the segregated revenues in the tribal trust fund were derived from the use of trust land (i.e., lease income) or trust resources (as opposed to from net gaming revenues or from business operations conducted by the tribe).

- Such distributions of tribal trust revenue would be subject to the same IRS standards concerning mischaracterized gaming revenues, mischaracterized business profits and mischaracterized compensation as distributions made to members from OST tribal trust accounts. However, safe harbors should be crafted to address the common practice of setting minimum lease payments with reference to a percentage of the lessee’s gross revenues.

Please support this important initiative to build on our recent track record of success and make the IRS Interim Guidance on the tax treatment of distributions from trust land revenues more workable for those tribes who have elected under the HEARTH Act to regulate their own leasing activities.