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**IRS announces proposed guidance on  
“essential government function” and “commercial activities” tests**

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Earlier today, Treasury and IRS (“IRS”) released an “Advance Notice of Proposed Rule Making” which includes guidance on defining “essential government functions” and “commercial activities” when determining whether a tribal plan will qualify for government status under Internal Revenue Code Section 414(d) as amended by the Pension Protection Act.

The Advance Notice is the first written guidance from IRS on this subject in more than four years, since the initial transition relief announced in Notices 2006-89 and 2007-67. It provides new insight on how IRS proposes to address key definitions impacting which tribal plans will retain government status, and seeks additional comments before the proposed regulations will be published.

**Bottom Line: Good or bad news for tribes?**

Yoder & Langford believes that the Advance Notice does not sufficiently recognize that generating revenue for public purposes is an essential function of tribal government. If left unchanged, the Advance Notice would provide an extremely narrow view of what will be considered a tribal “governmental activity”. In its present form, the guidance also does not respond to the many practical questions previously posed by tribes concerning how tribal governments are to coordinate compliance activities between multiple government and commercial plans.

Yoder & Langford is also concerned about statements within the Advance Notice that could be read to minimize tribal consultation rights - - - that the essential government function test does not “have substantial direct effects with respect to the Federal government and Indian tribes”. . .

The good news for tribal governments is that the Advance Notice is not yet binding, and that tribes will have an opportunity to provide comments and seek better guidance before regulations are put into final form.

The following is an executive summary of some of the key provisions in the Advance Notice:

**Definition of “Commercial Activities”:**

- The Advance Notice retains the same five “commercial” examples in the initial transition relief: [Hotels, Casinos, Service Stations, Convenience Stores, and Marinas](#).
- The Advance Notice, however, adds a “facts and circumstances” test identifying the following factors:
  1. Whether the activity is operated to earn a profit
  2. Whether the activity is typically performed by private businesses
  3. Whether the activity is on or off tribal lands, and whether customers are substantially from outside the Indian community

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### Definition of “Governmental Activities”:

- The Advance Notice provides several new examples of what IRS will deem to be a “governmental activity”
  1. Activities related to [building and maintenance of public roads, sidewalks, public buildings](#), and related areas, such as parking lots.
  2. Activities related to [public sewer and drainage facilities](#), and related facilities such as a [waste-water treatment plant](#).
  3. Activities related to [public works projects, such as schools and government buildings](#).
  4. Activities relating to [public utilities](#), such as electricity and other power sources, including development of newer and emerging technologies.
  5. Activities relating to criminal protection services, such as [police and fire departments](#), providing civil and public administrative services, such as [operating and managing public schools](#), managing and providing services at [public hospitals and health clinics](#), operating the [government’s civil services system](#), and other related public services.
  6. Activities subject to [treaty or special rules](#) that pertain to trust land ownership and use.
- The Advance Notice also provides a “facts and circumstances” test for governmental status, looking to the following factors:
  1. Whether the activity provides a public benefit to members of the Tribe (the “generation of revenue from commercial acts” is specifically not treated as a public benefit to the Tribe).
  2. Whether there is the absence of one or more factors for “commercial” status.

### New “location, payroll and duties” test for shared employees:

- The Advance Notice proposes to classify individuals between a Tribe’s government or commercial entities, including treatment of “shared” employees, by looking at three factors:
  1. Location. Does the individual work in a government or commercial building?
  2. Payroll. Does the government or a commercial entity pay the individual?, and
  3. Duties. How do the duties and responsibilities compare to the government and commercial activities test?
- Shared employees must be prorated between commercial and government plan participation based, for example, upon service credits or allocated compensation.
- Examples: The Advance Notice provides several examples on how the IRS would apply the “locations, payroll and duties” test:
  1. A [guard](#) assigned to provide security at a casino and on the casino payroll is a commercial employee.
  2. A [cashier](#) on the payroll of a convenience store is a commercial employee.
  3. A [bookkeeper](#) working in a government building and on the government payroll is nonetheless a commercial employee if the facts and circumstances indicate his or her assigned duties and responsibilities (other than temporary duties and responsibilities) are to maintain the books and records for a tribal hotel.

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4. The [chief financial officer](#) for a Tribe is governmental even if he/she spends a substantial amount of time working on the financing of a casino, when the duties and responsibilities are for a governmental activity.
5. A [tribal attorney](#) working in a government building on tribal land and on government payroll, assigned principally to review the operations of marina boat operators to ensure compliance with tribal rules and regulations, is a governmental employee when the duties and responsibilities are to provide government oversight.
6. A [police officer](#) working from the tribal police station located in a government building on tribal land is a government employee even though he/she “occasionally” must go to the casino on patrol.

### New “government” versus “commercial” examples:

The Advance Notice also contains several new examples to illustrate how IRS would construe the above rules:

- A community [swimming pool](#) owned and operated by a Tribe on reservation that primarily benefits tribal members without charge is “governmental” even if non-members must pay a fee to use the pool.
- A [cultural center](#) and [museum](#) owned and operated by a Tribe on reservation to preserve and showcase tribal culture, crafts and artistry is “governmental” even if it has a “small gift shop, a theater and various activity rooms” and a majority of its visitors are not tribal members.
- An [RV park](#) or [campground](#) facility primarily serving non-member tourists for a fee is “commercial” because it is like other for-profit businesses and includes customers who are substantially from outside the Tribe.
- A [bank](#) owned and operated by a Tribe on reservation that serves both tribal and non-tribal customers (both on and off tribal land) with no fee preference is “commercial” because it is operated for-profit like other private businesses.
- A [trucking business](#) whereby the Tribe purchases and leases trucking equipment is a “commercial” activity because it is operated to earn a profit and of a type performed by other private businesses.
- A [factory](#) on tribal land that produces goods for sale primarily to non-tribal customers for profit is “commercial”
- A factory on tribal land that produces goods to promote and display the [culture](#) of the Tribe may, however, be “governmental” (depending on all facts and circumstances) even if the goods are sold primarily to non-tribal customers.

### Other points of interest:

- For now, the prior transition relief (Notice 2006-89 and Notice 2007-67) continues to apply. The Advance Notice warns, however, that continued relief under the reasonable good faith standards is available only if government plan benefits are not higher than commercial plan benefits.
- The Advance Notice does not provide any substantive guidance on how to administer separate commercial and government plans, or how to coordinate IRS submission deadlines or control group rules.
- The Advance Notice concludes that Executive Order 13175 consultation is not required because the essential government function and commercial activity rules do not have “a substantial direct effect with respect to the federal government and Indian tribes”.

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- IRS is seeking written comments and will be conducting “consultation listening meetings” and public hearings

### Conclusion:

The Advance Notice and the proposed regulations do not reflect many of the issues contained in the extensive comments previously submitted on essential government function and commercial activity tests, including those previously submitted by Yoder & Langford, P.C., the Profit Sharing/401(k) Council of America (“PSCA”), the Native American Finance Officers Association (“NAFOA”), and individual tribes. It will be extremely important for Tribes and Tribal associations to submit detailed comments in response to the Advance Notice. The deadline for comments is **February 6, 2012**. The Advance Notice also indicates that the IRS will be hosting additional regional meetings to discuss this guidance project with the Tribes and Tribal representatives. The Tribes’ voices are essential in this process - if Tribes do not make themselves heard, the final guidance will not reflect the autonomy, individuality and needs of the Tribes.

This summary is intended as a high level overview of the Advance Notice of Proposed Rulemaking on IRS proposed regulations under Internal Revenue Code Section 414(d) with regard to Indian tribal government plans. This summary is not intended as a substitute for the actual text of the Advance Notice or to serve as legal advice. The determination of government status of a particular entity will depend on many factors unique to each entity. No examples set forth in this summary should be deemed a conclusion with regard to the legal status of any specific entity or class of entities.

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