



# Options for Designing Your Tribal Philanthropic Program



Strengthening Native American Philanthropy  
June 2009



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### Strengthening Native American Philanthropy (SNAP)

First Nations Development Institute was founded in 1980 with the mission to assist Native communities control their assets and build capacity to direct their own economic futures in ways that fit their culture. Since 1995, through the Strengthening Native American Philanthropy (SNAP) program, First Nations has been working to enhance the role of Native Americans as participants in, and better recipients of, private philanthropy. This program evolved to respond to an increasing interest in formal giving in Indian Country, and to new strategies for creating philanthropic structures among tribes and inter-tribal associations. The goals of our SNAP program are to:

- Strengthen the climate for tribal participation in philanthropy.
- Increase social investment in tribes and the Native American nonprofit sector.
- Develop new mechanisms for enabling Native American tribes and organizations to be self-sustainable – to control financial assets, and to create new philanthropic funds and organizations.
- Create and strengthen autonomous grantmaking institutions that will support tribal and community-based organizations working to address critical community needs.
- Raise awareness and provide a forum for Native and non-Native donors to access and exchange information on effective grantmaking in Indian Country.

# TABLE OF CONTENTS

<b>Introduction</b> .....	<b>1</b>
<b>Why Create a Formalized Philanthropic Model?</b> .....	<b>2</b>
<b>Basic Beginnings of Philanthropic Organizations</b> .....	<b>3</b>
Nonprofit Corporations .....	3
Advantages of Incorporation .....	4
Incorporation under State Law .....	4
Advantages of Incorporation under State Law .....	5
Incorporation under Tribal Law .....	5
Advantages of Incorporation under Tribal Law .....	5
Tribal Philanthropic Program .....	6
<b>Gaining Nonprofit Status</b> .....	<b>8</b>
Internal Revenue Code Section 501(c)(3) Charitable Organizations .....	10
“Public Charities” vs. “Private Foundations” .....	12
Advantages of IRC Section 501(c)(3) Charitable Status .....	13
Disadvantages of IRC Section 501(c)(3) Charitable Status .....	13
Current Tribal Organizations with 501(c)(3) Status .....	13
Internal Revenue Code Section 7871 and Tribal Philanthropic Programs .....	14
Advantages of IRC Section 7871 Status .....	14
Note: Treatment of Private Foundation Grants .....	16
Disadvantages of IRC 7871 Status .....	17
Examples of 7871 Organizations .....	17
<b>Additional Uses of Tribal Philanthropic Models</b> .....	<b>19</b>
Tribal governmental program under which gaming revenue can be used to provide tax-free benefits to tribal members .....	19
Educational Benefits Program .....	20
Scholarship Program .....	20
Health Benefits Program .....	21
General Welfare Programs .....	21
Economic Development Program .....	22
Housing Assistance Program .....	22
Elders Assistance Program .....	22
Deferred Per Capita Plan .....	23
Deferred Income Plan .....	23
Spending Approach not Viable .....	23
Conclusion .....	23

Other Advantages of the Use of Philanthropic Models . . . . .	24
Increase Respect for the Tribe and Improve Public Relations . . . . .	24
Responsibly Manage Tribal Wealth . . . . .	24
Support “Civil Society” in the Local Community . . . . .	24
<b>Conclusion . . . . .</b>	<b>25</b>
<b>Bibliography . . . . .</b>	<b>26</b>
<b>Tables</b>	
Table 1. Types of Philanthropic Models . . . . .	12
<b>Figures</b>	
Figure 1. Steps to Creating a Tribal Philanthropic Organization . . . . .	9
Figure 2. IRC Sec. 501. Exemption from Tax on Corporations, Certain Trusts, etc. . . . .	11
Figure 3. IRC Sec. 7871. Indian Tribal Governments Treated as States for Certain Purposes. . . . .	14



# INTRODUCTION

## Options for Designing Your Tribal Philanthropic Program

The basis of this component of the Strengthening Native American Philanthropy series is to provide information on the major principles pertaining to the creation of a formalized philanthropic model. In addition to providing information about the basic legal structures and requirements of mainstream philanthropic models, this component also provides information related specifically to tribes and tribal models.

Much of this document is devoted to helping the reader become more familiar with the two most common philanthropic models found in Native communities. The two models are: the 501(c)(3) organization, named after the part of the IRS code that defines those organizations, and the Section 7871 organization, which also gets its name from the section of IRS code that enables it. This document concludes with examples of successful tribal philanthropic organizations with the hope that a reader with little to no previous experience in philanthropy can gain a basic working knowledge of the field.

For the sake of clarity, a brief note on the use of terminology within this booklet is necessary. The term “philanthropic model” is broadly used to describe any formalized giving structure, including structures created under tribal law and structures created under state or federal law.

The following material is not intended, nor should it be construed, as legal advice but rather as an introduction to the field of philanthropy. The services and advice of a lawyer, especially within the areas of tax and tribal law, are **essential and highly recommended** if/when implementing any of the philanthropic initiatives mentioned in this booklet.



# WHY CREATE A FORMALIZED PHILANTHROPIC MODEL?

## There are several advantages for a tribe to create a formalized philanthropic model:

- It provides a means for the values and aspirations of the tribe to be realized.
- It brings visibility to tribal giving.
- It allows the tribe to direct its giving and to focus its resources.
- It allows the tribe to collaborate with other donors to affect change.
- It allows the tribe to leverage the funding within the philanthropic program for economic development.
- It may provide the tribe the opportunity to play a more active role in the causes to which it contributes.
- It frees the tribal council or decision-making body from reading and deciding on each and every proposal.
- It lets potential applicants know what the process is for proposal review and how to follow it.
- It allows tribal members who give to deduct the amount donated from their income tax.

These advantages underscore the usefulness of a formalized philanthropic model, but the question remains as to the best means of forming such a program. There are a number of philanthropic models that can promote Native American causes and even some that can strengthen tribal sovereignty, such as nonprofit incorporation under tribal law. Briefly, a few examples of common philanthropic models are provided below. Each of the models described below has different tax consequences for both the organization and the donor. The information below contains general characteristics of these tax consequences only; ***the advice of an experienced tax attorney is essential when determining the best vehicle for your organization.***



# UNDERSTANDING THE BASICS OF PHILANTHROPIC ORGANIZATIONS

Once a tribe has decided they wish to create a formalized philanthropic model, the next step is to decide what model should be developed. Dependent upon the needs and wishes of the tribe, there are two main models available: nonprofit corporations (501(c)(3) organizations) and tribal philanthropic programs (Section 7871 programs).

## Nonprofit Corporations

The most common philanthropic model is achieved through the creation of a legal entity known as a corporation. Corporations can be created under either tribal law or state law.

Under state and federal law (and usually tribal law), a corporation is treated as a separate “person” for the purposes of making contracts, paying taxes, and being liable for the consequences of its business activities. The filing of *Articles of Incorporation* starts the process that creates a corporation. Articles of Incorporation are generally thought of as an agreement between the incorporators (people or organizations wanting to create the nonprofit) and the state or tribe about the functions, responsibilities, and obligations of the corporation. In short, it is important to incorporate because doing so creates a legal entity that the state or tribe will recognize, thus giving the incorporated entity certain legal rights and responsibilities.

There are two general types of corporations: commercial or for-profit corporations, and nonprofit corporations. A commercial corporation is the type generally seen in everyday life and examples include IBM, McDonalds, and Warner Brothers. The purpose of for-profit corporations is to carry out a certain business with the goal of earning profits for the corporation’s shareholders. The for-profit corporation is not used in the creation of philanthropic models, and subsequently will not be discussed.

In contrast, a nonprofit corporation is organized for other than profit-making purposes, generally for charitable and philanthropic purposes. Since their inception in the United States, nonprofit corporations have contributed to a variety of fields including science, medicine, history, education, economics, and healthcare. In our modern society, the nonprofit sector complements the two other principal sectors, the private sector and government sector, by providing a “third sector” to better provide social services that the private and government sectors may not be able to. Examples of such nonprofits include the United Way, the Red Cross, and most colleges and universities. For the non-Native community, a nonprofit is generally created utilizing state law. Each state and tribe should have a statute that sets out the procedure for creating a nonprofit corporation and the boundaries within which a nonprofit must operate.



### **Advantages of Incorporation**

There are several advantages to creating a corporation for a formalized philanthropic model.

- **Limited Liability:** Under all state and many tribal laws, the officers, directors, employees, and members of a corporation are generally not personally liable for legal judgments and debts relating to the nonprofit corporation. In addition, within the tribal context, because the nonprofit corporation is a separate legal entity from the tribe, assets of the tribe generally cannot be used to satisfy a judgment or debt of the nonprofit corporation.
- **Accountability and Stability:** When people and organizations interact with a corporation, they expect bylaws to be in place ensuring the accountability of the corporation to its business partners. In addition, there is a reasonable expectation that the corporation will continue to exist even if there are changes in staff. Such accountability and stability within a corporation provide confidence to the people and organizations interacting with the corporation that it is a safe place to do business.
- **Tax Advantages:** Nonprofit corporations are generally exempt from federal income taxes as well as from many state and local taxes. Nonprofit corporations that are charitable, educational, religious, literary, or scientific are almost always tax-exempt; the related tax advantages of such corporations will be elaborated upon later in this booklet.

### **Incorporation under State Law**

There are two options for incorporation: state law or tribal law. Most nonprofit corporations are incorporated under state law. When tribes want an entity to be recognized as a corporation by a state government they must file *Articles of Incorporation* with the state. Each state has a different process for applying but there should be an abundance of information available on the process because it is a common function of state government. Two state agencies that generally oversee the regulation and incorporation of legal entities are the *Office of the Attorney General* and *Office of the Secretary of State*. However, it is worth looking into the special rules governing nonprofit corporations before filing *Articles of Incorporation*. Of course, it is essential and highly recommended that a qualified attorney or accountant is consulted during the process of incorporation.

Applying to the IRS for 501(c)(3) status usually occurs after state or tribal incorporation. 501(c)(3) status, which will be discussed shortly, is the most well known category that allows nonprofits tax-exemption. All nonprofits, whether they are created under state or tribal law, must register with the IRS for tax-exempt or 501(c)(3) status.

If you decide to incorporate under state law, there are some advantages.



### **Advantages of Incorporation under State Law**

- **Brevity and Efficiency:** The procedure of incorporation under state law is a standard process, and therefore the procedure is relatively quick and easy. Both regulators and donors are familiar with corporations chartered under state law, which could make donors more comfortable with supporting nonprofits regulated by the state law.
- **Accountability:** A nonprofit corporation is accountable to its funders and the state that it is incorporated in. States have pre-established rules and standards of conduct that will be enforced by state agencies. A state incorporated charity, required to adhere to state standards, might be perceived as a more secure charity to donate to than charities incorporated under tribal law.

### **Incorporation under Tribal Law**

Within the context of Indian Country, a tribe, individual, or group can opt to exert tribal sovereignty by using tribal law to create a nonprofit corporation instead of state law. While not all tribes have a legal code for incorporation, many tribes do. Tribes that do have such laws generally model them after the state law. The first step for those interested in nonprofit incorporation under tribal law is to find out whether their tribal code provides for such incorporation.\* If there are provisions for nonprofit incorporation in tribal code, it is also important that regulations are in place with agencies or people available to monitor tribally incorporated nonprofit activities. Your tribal government headquarters is probably a good place to find your tribe's code and someone at the headquarters should be able to offer assistance if you have trouble locating the code. Applying for tribal incorporation should not be drastically different than applying for state incorporation. Usually filing *Articles of Incorporation* is necessary. If a tribe, individual, or group decides to use tribal law for incorporation, there are some advantages.

### **Advantages of Incorporation under Tribal Law**

- **Self Determination/Sovereignty:** In utilizing its own laws, a tribe is exercising its inherent sovereignty to create the corporation.

\* If your tribe has no such code, then visit First Nations Development Institute's website ([www.firstnations.org](http://www.firstnations.org)) for model tribal codes.

### **Incorporation Under Tribal Law: The Cherokee Nation Education Corporation**

In 1996, the Cherokee Nation in Tahlequah, Oklahoma, passed legislation that made it possible to create a nonprofit corporation under tribal law. This legislation codified the tribal government's ability to create nonprofit corporations. In 1998, the Cherokee Nation Education Corporation filed incorporation papers through the Office of the Secretary of the Cherokee Nation. The Cherokee Nation Education Corporation was then chartered under tribal code.

In 1997, the Cherokee Nation Education Corporation had submitted an IRS Form 1023 application to the IRS to receive 501(c)(3) status. In August 1998, First Nations Development Institute received a letter of clarification from the Internal Revenue Service that found that nonprofit corporations chartered under tribal law could be recognized by the IRS for 501(c)(3) status. In October 1998, the Cherokee Nation Education Corporation was granted recognition of exemption under section 501(c)(3) by the Internal Revenue Service.

The mission of the Cherokee Nation Education Corporation is to provide educational assistance and preserve the language, culture, and history of Cherokee people. Because the Internal Revenue Service recognizes the Cherokee Nation Education Corporation as a 501(c)(3) corporation, contributions to the nonprofit are tax-deductible within the limits of the tax code.

### **Tribal Philanthropic Program**

Another means to engage in philanthropy is to create a tribal philanthropic program. Such a program would not be operated by a separate corporation nor would it need to seek 501(c)(3) status, but would simply be a program of the tribe similar to a health program, a housing program, or a social service program. For example, the Spirit of the Salmon Fund is a tribally sponsored philanthropic organization that is structured to be both a grantmaker and grantseeker, and has a letter from the IRS recognizing its Section 7871 status (Section 7871 status is discussed in greater detail below). Internal Revenue Code Section 7871 states that tribal governments must be treated like state governments for certain tax purposes. It allows tribal governments, their political subdivisions, or a department or division that is an integral part of a tribal government, to receive tax-deductible donations.

A tribal giving program has both advantages and disadvantages. Briefly, the advantages of such a program include the following:

- The tribe does not have to complete the process for incorporation.
- The tribe does not have to apply to the IRS for tax-exempt status under section 501(c)(3).
- The tribe has more control over the organization.

However, there are also some disadvantages to the tribal giving program/7871 structure. These include the following:

- There is a lack of separation of the tribe from the program, and the organization may be subject to tribal politics as a result.
- There is a potential lack of understanding from funding agencies regarding the structure of the program, and most importantly, the tax consequences for donations to the giving program.

The latter disadvantage may not seem particularly pressing to those tribes with a steady, secure stream of income dedicated to such a giving program. However, for many tribes, such a stream of income is not available. Consequently, in order for a tribal giving program to have the funds necessary to continue and augment its giving program, fundraising is necessary. The key to raising funds is to make the donation of such funds attractive to the donor, that is, to allow the donation to be tax-deductible. Many foundations and individual donors do not understand the nature of tribal programs or 7871 programs and therefore are sometimes hesitant to donate to tribal programs.

# GAINING NONPROFIT STATUS

There are two paths a tribe can take to create a philanthropic program. Tribes can create a nonprofit corporation, or a tribal philanthropic program (see Figure 1). After the tribe chooses the model to pursue, the next step is to apply to the IRS for recognition of 501(c)(3) status for the organization, or to establish the program as a department or integral part of a qualified Indian tribal government under Section 7871.

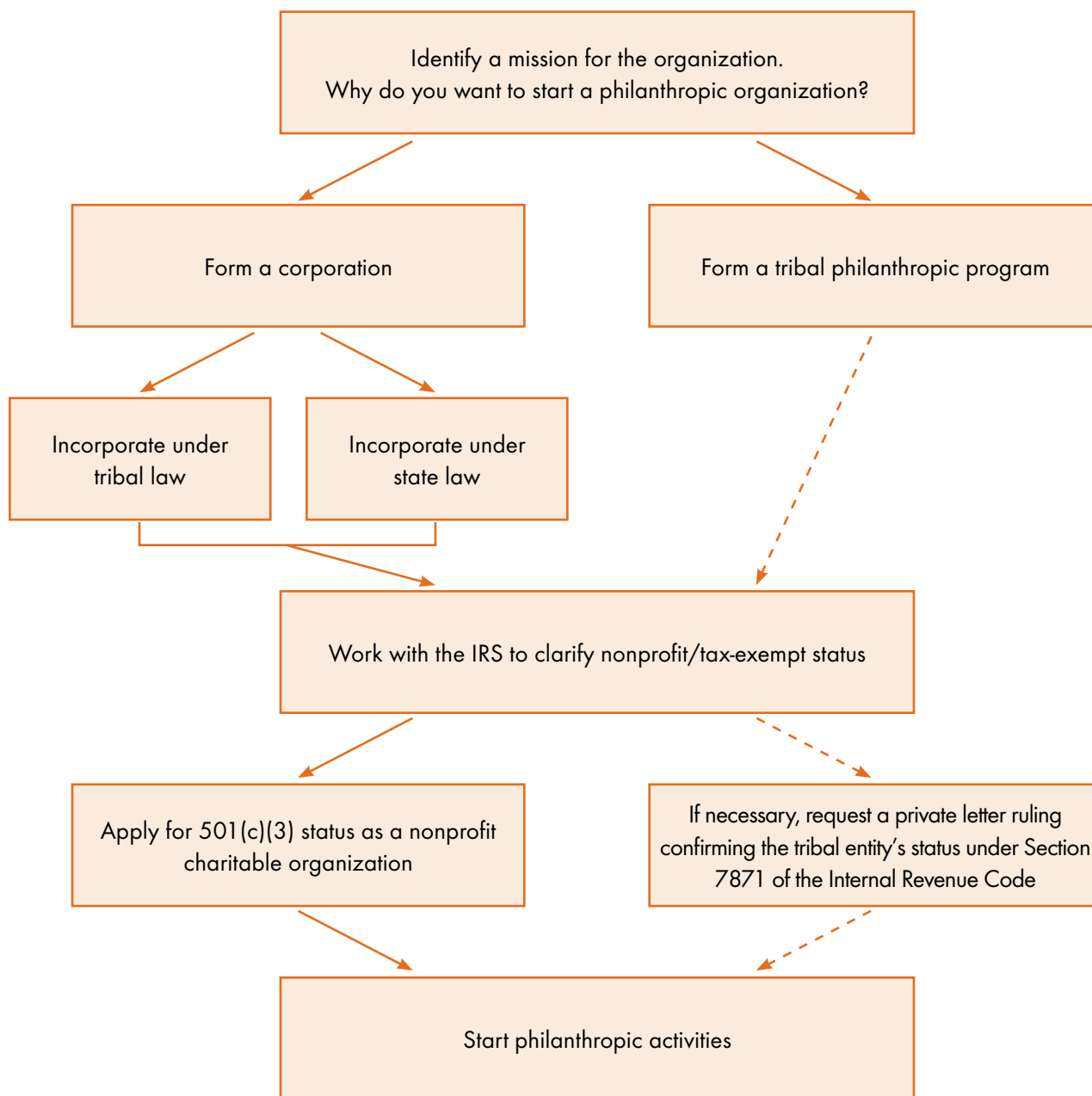
The importance of receiving recognition from the IRS is two-fold:

- **Tax-Deductible Donations:** In order to attract individual and funding agency donations, it is important to have tax-exempt status so that donations will be tax deductible for the donor. Although philanthropic giving is mostly done for altruistic reasons, the more pragmatic tax advantages are also a persuasive reason for such giving. A donation that is tax deductible for the donor provides an attractive reason for making such a donation to a philanthropic program. Consequently, it is important that a philanthropic program ensure that donations made to it are tax-exempt for the donor.
- **Tax-Exempt Status:** A corporation is not exempt from taxation unless it has been recognized by the IRS as tax-exempt (generally, under section 501(c)(3) status). Therefore, it is necessary to seek IRS approval to gain tax-exempt (charitable) status. Tribal philanthropic programs (to the extent they are an integral program of the tribe) are already exempt from taxation so this issue is not as important for such programs. However, it may be necessary to get a private letter ruling from the IRS regarding the tribe's status under Section 7871 of the Internal Revenue Code (discussed in greater detail below). Such a letter is helpful for educating funders and others about the philanthropic program.

Figure 1 provides an overview of the paths that a tribe may take to create a philanthropic model. These options will be discussed in greater detail, but an illustration is useful at this point.



**Figure 1: Steps to Creating a Tribal Philanthropic Organization**



## Internal Revenue Code Section 501(c)(3) Charitable Organizations

Although the creation of a nonprofit corporation is done through tribal or state law, charitable status is achieved by meeting the requirements set out in the federal Internal Revenue Code (IRC). While it is true that federal tax-exempt status is available only to nonprofit corporations, the reverse is not true, namely a corporation designated to be a nonprofit is not automatically federally tax-exempt.

To obtain tax-exempt status as a charitable organization, an organization must meet the qualifications found in IRC Section 501(c)(3). You have several models available to you when designing a 501(c)(3) charitable organization. Among the models are the following:

- **Public Charity/Nonprofit Organization.** This includes nonprofit social service, environmental, educational, or advocacy organizations. Examples include First Nations Development Institute, the Intertribal Agricultural Council, the Red Cross, and the United Way. Most nonprofit organizations are grantseeking organizations, but some do give grants as well. For example, First Nations Development Institute is both a grantseeking organization and a grantmaking organization.
- **Private Foundation.** Private foundations are usually grantmaking organizations. They are structured somewhat differently than standard nonprofit organizations, and usually have an endowment to support their grantmaking activities. Examples of private foundations include the Lannan Foundation, the Ford Foundation, and the W. K. Kellogg Foundation.
- **Community Foundation.** A community foundation must target its philanthropic work to a specific geographic area. Community foundations typically are both grantseeking and grantmaking organizations. Examples of community foundations include the Arizona Community Foundation and the Greater Milwaukee Community Foundation.

**According to IRC Section 501(c)(3), to be tax-exempt an organization must have the following:**

- Organized and operated exclusively for one or more of the purposes outlined in the section.
- None of the organization's earnings can inure to any private shareholder or individual.
- The organization may not attempt to influence legislation as a substantial part of its activities, nor may it participate in any political campaign activity.

According to IRC Section 501(c)(3), to be tax-exempt an organization must be organized and operated exclusively for one or more of the purposes outlined in the section, and none of the organization's earnings can inure to any private shareholder or individual. In addition, the organization may not attempt to influence legislation as a substantial part of its activities, nor may it participate in any political campaign activity. The appropriate form needed to apply for federal exemption under section 501(c)(3) is IRS Package 1023. A copy of this form can be printed from the IRS website. This is a technical form and will require the help of a specialist. Figure 2 below provides a more detailed discussion of the requirements of 501(c)(3) organizations.

**Figure 2: IRC Sec. 501. Exemption from Tax on Corporations, Certain Trusts, etc.**

(a) Exemption from taxation

An organization described in subsection (c) or (d) or IRC Section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under IRC Section 502 or 503.

...

(c) List of exempt organizations

The following organizations are referred to in subsection (a):

...

- (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for *religious, charitable, scientific, testing for public safety, literary, or educational purposes*, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

**“Public Charities” vs. “Private Foundations”**

Since 1969, the United States Tax Code has drawn a clear distinction between “public charities” and “private foundations.” Both are 501 (c)(3) organizations, but “public charities” and “private foundations” are treated differently for tax purposes depending on their IRS classification. To further confuse the issue, the terms “public charity” and “private foundations” are legal terms and often have no relationship to the titles of different types of philanthropic organizations. For example, a community foundation is technically a “public charity” even though it uses the term “foundation” in its title. Although both types of organizations may use the term “foundation” in their titles, they are treated differently for tax purposes depending on their IRS classification. Table 1 provides an overview of the different types of organizations that may be considered “public charities” and “private foundations.”

**Table 1: Types of Philanthropic Models**

	Public Charity	Private Foundation
Types of Philanthropic Models	Social Service Nonprofit Housing Nonprofit Education Nonprofit Museum Hospital Community Foundation	Family Foundation Corporate Foundation
Examples	National American Indian Housing Council American Indian College Fund The Chickasaw Foundation The Hopi Foundation The Smithsonian Museum First Nations Development Institute	The W. K. Kellogg Foundation The Ford Foundation The William and Melinda Gates Foundation

As mentioned above, “public charities” and “private foundations” are treated differently for tax purposes depending on their IRS classification. We recommend that you consult an attorney on this topic.

The importance of determining whether you want your charitable organization to be a public charity or private foundation is focused on the tax advantages. Generally, a private foundation has more requirements for how it manages its money than a public charity. The ability of a charitable organization to meet the public charity requirements provides a definite tax benefit to the organization.



**Advantages of IRC Section 501(c)(3) Charitable Status**

There are several substantial benefits in obtaining Section 501(c)(3) charitable status, including:

- The nonprofit is exempt from federal income taxes (other than unrelated business income taxes (UBIT)).
- Persons contributing to the nonprofit may be able to use the contribution as a deduction on their own income taxes.
- There is a well-established body of law for the treatment of nonprofit 501(c)(3) organizations, and several well-established state and national associations to represent their interests.
- Most major donors, such as United Way, will not make donations to organizations without Section 501(c)(3) charitable status (although this is changing as foundations learn more about tribal philanthropic programs).

**Disadvantages of IRC Section 501(c)(3) Charitable Status**

There are also a few disadvantages of 501(c)(3) charitable status, including the following:

- The organization must file a tax form (either Form 990 or Form 990 PF) with the IRS on an annual basis.<sup>1</sup> While there is more paperwork required for a 501(c)(3) organization than a 7871 organization, such paper work (including the Form 990) is a widely accepted practice that assures your donors of your organization's accountability and integrity.
- The organization, if incorporated under state law, is subject to state law rather than tribal law. In contrast, organizations created as part of the tribal government or under tribal law are subject to tribal law, which is the case with a 7871 organization or nonprofit corporations created under tribal law.

**Current Tribal Organizations with 501(c)(3) Status:**

There are a number of 501(c)(3) organizations that were created as philanthropic organizations by tribes and serve tribal communities or work in Native communities. They include:

- The Chickasaw Foundation.
- The Cherokee Preservation Foundation (Eastern Band Cherokee, North Carolina).
- The Cherokee Nation Education Foundation (The Cherokee Nation, Oklahoma).
- The Laguna Education Foundation.
- The Hopi Foundation.

### Internal Revenue Code Section 7871 and Tribal Philanthropic Programs

In 1982, Congress passed the **Indian Tribal Governmental Tax Status Act**. This legislation, codified as IRC Section 7871, treats tribal governments as state governments for certain tax purposes. It allows tribal governments, their political subdivisions, or any tribal governmental fund, entity or program, that is an **integral part** of a tribal government, to receive tax-deductible donations.

**Figure 3. IRC Section 7871. Indian Tribal Governments Treated as States for Certain Purposes**

- (a) General rule. An Indian tribal government shall be treated as a State –
  - (1) for purposes of determining whether and in what amount any contribution or transfer to or for the use of such government (or a political subdivision thereof) is deductible under –
    - (A) Section 170 (relating to income tax deduction for charitable, etc., contributions and gifts),
    - (B) Sections 2055 and 2106(a)(2) (relating to estate tax deduction for transfers of public, charitable, and religious uses), or
    - (C) Section 2522 (relating to gift tax deduction for charitable and similar gifts);
  - ...
  - (7) for purposes of –
    - (A) chapter 41 (relating to tax on excess expenditures to influence legislation), and
    - (B) subchapter A of chapter 42 (relating to private foundations).

To qualify for the tax benefits of IRC Section 7871, a tribal government must be recognized by the Department of the Treasury, in consultation with the Department of the Interior, as an entity that exercises sovereign powers (in other words, a federally recognized tribe). The division of the tribal government that is applying for Section 7871 recognition must be a political sub-division or integral part of a tribal government with the power to exercise one of three sovereign powers: 1) the power to tax; 2) the power to police; or 3) the power of eminent domain. The division of the tribal government must also be a political sub-division designed for exclusively public purposes.

#### **Advantages of IRC Section 7871 Status**

As mentioned earlier, IRC Section 501(c)(3) allows a nonprofit corporation to obtain tax-exempt status as a charitable organization. IRC Section 7871 treats Indian tribes like states for most federal tax purposes, including determining whether and in what amount a contribution to a tribal government is deductible as a charitable contribution. Because charitable donations to federally recognized tribal governments are tax deductible for the donor (as are donations to state and local governments), once a tribal giving program is ruled to be a Section 7871 organization, donations to it are tax deductible.

While most legal experts acknowledge that donations to a tribal government or integral part are tax deductible to the donor, it is a good idea to get a ruling from the IRS for your organization.

Although federally recognized tribal governments are the primary intended beneficiaries of Section 7871, there are two other governmental units that can also qualify for such benefits:

- Tribal political subdivisions.
- “Integral parts” of tribal governments and their subdivisions.

A political subdivision is a unit of the government that has been delegated one or more sovereign powers, such as the power to tax. In order to be recognized as such for Section 7871 purposes, the subdivision should utilize the IRS private letter ruling process to receive a determination that it is indeed a political subdivision of the tribal government. As part of the private ruling process, the IRS looks to the Department of Interior for assurance that the entity has been delegated the requisite sovereign power(s).

The IRS has not published formal guidance on qualifying as an “integral part” of an Indian tribal government. Based on a series of private letter rulings issued under Section 7871 there appears to be several relevant factors:

- i. The entity is not separately incorporated under state law.
- ii. The tribal government exerts a substantial degree of control over the entity.
- iii. The tribal government is liable for the acts of the entity.
- iv. The entity is essentially an operating unit or agency of the tribal government.
- v. The tribal government has made a substantial financial commitment to the entity.

It is important to note that the IRS has never required that “integral part” entities secure an IRS private letter ruling but many tribes have done so in order to be certain of their tax benefits.

**To qualify for the tax benefits of IRC Section 7871, a tribal government must be:**

- ▶ Recognized by the Department of the Treasury, in consultation with the Department of the Interior, as an entity that exercises sovereign powers.
- ▶ The division of the tribal government that is applying for Section 7871 recognition must be:
  - A political sub-division of a tribal government with the power to exercise one of three sovereign powers:
    1. The power to tax;
    2. The power to police; or
    3. The power of eminent domain; and
  - A political sub-division designed for exclusively public purposes.

There are several substantial benefits to obtaining Section 7871 status, including:

- An IRC 7871 entity is generally not separately incorporated like most 501(c)(3)s. This means a 7871 is generally not subject to applicable state law, whereas a 501(c)(3) entity, created under state law (rather than tribal law), is subject to state laws and regulation.
- An IRC Section 7871 organization can be structured as a tribally controlled fund, agency, or committee and therefore it is a more flexible form than a charitable corporation.
- As an integral part of a tribal government, an IRC Section 7871 organization is not as restricted as a 501(c)(3) organization with respect to public advocacy and lobbying activities.
- An IRC Section 7871 organization is not subject to annual reporting requirements, charitable substantiation and disclosure rules, or the UBIT rules that apply to IRC Section 501(c)(3) organizations. However, most philanthropic donors require some form of reports and accountability before they will donate to a 7871 organization.

**Note: Treatment of Private Foundation Grants**

When a governmental unit applies for a grant from a private foundation, it is sometimes asked to provide proof of its tax status because of certain restrictions on a private foundation imposed by the IRS Code. These restrictions are set forth in subchapter A of Chapter 42 of the Internal Revenue Code (i.e., Code Sections 4940-4948). One such restriction imposes an excise tax on private foundations that fails to make sufficient “qualifying distributions.” Under Section 4942 of the Code, private foundations must distribute certain amounts for charitable purposes each year - so-called “qualifying distributions” - or incur an excise tax on the undistributed amount. “Qualifying distributions” include certain amounts paid to accomplish charitable purposes.

Based on IRS regulations interpreting the private foundation excise taxes, private foundation grants made to states and municipalities constitute “qualifying distributions” even where the state or local government entity does not have Section 501(c)(3) status. Section 7871(a)(7)(B) of the Code specifies that an Indian Tribal Government shall be treated as a state for purposes of Subchapter A of Chapter 42 of the Code. However, because Section 7871 was enacted after the regulations under Sections 4942 were promulgated, a question has arisen whether these same rules apply to Indian Tribal Governments. The IRS has not published any formal guidance on this particular issue. However, the IRS has reached a similar legal conclusion in a General Information Letter issued by the IRS on September 9, 1998 to First Nations Development Institute (the “First Nations” letter).<sup>2</sup>

This letter reaches conclusions strikingly similar to a sample General Information Letter issued to state governments and published in the Internal Revenue Manual.<sup>3</sup> The First Nations letter starts with the premise that a qualified Indian Tribal Government - i.e., one which has been recognized by the Secretary of the Treasury as exercising sovereign powers - is treated as a state for the purposes specified in Section 7871. As stated above, Section 7871(a)(7)(B) of the Code specifies that an Indian Tribal Government shall be treated as a state for purposes of Chapter 42 of the Code (which includes Section 4942). Because private foundation grants made to States and their political subdivisions are treated as qualifying distributions, the First Nations letter concludes that foundation grants made to Indian Tribal Governments for public purposes should also be treated as qualifying distributions.<sup>4</sup>

Even though a General Information Letter is not a formal IRS ruling, the First Nations letter confirms that reliance on Section 7871 in establishing charitable and philanthropic tribal entities as potential recipients of both charitable contributions and private foundation grants is not misplaced. Where a tribe (including a political subdivision or integral part of such tribe) has been recognized as a qualified Indian Tribal Government, the same treatment that is extended to states with respect to private foundation grants and charitable contributions should be extended to such entities.

### **Disadvantages of IRC Section 7871 Status**

There are some issues that need to be considered by tribes anticipating creating an IRC Section 7871 organization, including the following:

- Contributions made to IRC Section 7871 entities must be used for exclusively “public purposes” – a term that is not yet clearly defined in case law and rulings.
- All foundations that provide donations to the organization will require reporting and accountability for funding expenditures and many will require outside audits whether or not IRC Section 7871 requires such an audit.
- There is a lack of separation of the tribe from the program, and the organization may be subject to tribal politics as a result.
- Some private foundations are still hesitant to make donations to governmental entities (including tribal entities with Section 7871 status) because they have not been educated about the tax-deductible nature of their donations.

### **Examples of 7871 Organizations**

There are currently a few tribal philanthropic programs that are operating as 7871 organizations. These include the following:

- The Oneida Nation Foundation.
- The Spirit of the Salmon Fund.
- The Hopi Education Endowment Fund.

### **The Oneida Nation Foundation**

The Oneida Nation Foundation, a 7871 tribal program created in 2000, is designed to support greater opportunities for the Haudenosaunee people (members of the Iroquois Confederacy) and those working for the benefit of all American Indians. The Foundation is a subdivision of the Oneida Indian Nation of New York tribal government and was created to formalize pre-existing Oneida philanthropy.

As a program of the government, the Oneida Nation Foundation is not required to have the same organizational structure as a separate legal entity (such as a 501(c)(3) organization). The tribe established a committee to process and approve grant proposals. Recently, the Foundation pledged \$10 million to the National Museum of the American Indian and endowed a \$3 million professorship at Harvard Law School to be held by an American Indian law scholar.

### Spirit of the Salmon Fund

The Columbia River Inter-Tribal Fish Commission, a political subdivision of four Pacific Northwest tribes, created the Spirit of the Salmon Fund in 1999. As a political subdivision of the Yakama, Nez Perce, Umatilla, and Warm Springs tribes, the Columbia River Inter-Tribal Fish Commission qualified as a 7871 entity. However, in applying for funding from foundations, the Commission found itself often explaining its governmental status to funders, which stretched a limited staff. To facilitate non-tribal solicitation of funds, the Commission established the “Spirit of the Salmon Fund” in 1999. Though the Spirit of the Salmon fund is an integral part of the Commission (and thus falls within the definition of an Indian tribal government for tax purposes), it has provisions very similar to a 501(c)(3) organization such as mandatory reporting, written acknowledgement of donations, and a “no lobbying” clause. This arrangement allows for the four tribes to maintain sovereignty over the Inter-Tribal Commission, which could have been undermined if the Spirit of the Salmon Fund were incorporated as a 501(c)(3) under Oregon law, but also satisfies funders’ concerns about the Fund’s operations.

Today, the Spirit of the Salmon Fund supports many programs including the Salmon Corps, an educational and employment program designed to increase disadvantaged adolescents’ understanding of nature while promoting a sense of individual responsibility. As part of its parent political subdivision, the Spirit of the Salmon shares offices and staff with the Columbia River Inter Tribal Fish Commission.

### Additional Uses of Tribal Philanthropic Models

There are many advantages to developing tribal philanthropic models. The general conception of philanthropy is that it is a means of providing charity to people or communities in need. While this is often a primary goal, it is by no means the only use of philanthropic models, particularly with tribes. Tribal philanthropic models can be used to distribute gaming revenues to eligible tribal members in a way that is not federally taxable, as per capita payouts are. Economic development efforts may also be aided by tribal philanthropic models. In addition, philanthropic models can also be used for less obvious purposes, such as improving the status of the tribe in public relations, and providing a responsible, long term economic planning tool for tribal wealth. The following is a brief discussion of some of these possibilities.

#### FOOTNOTES

<sup>1</sup> There is at least one exception to this rule. The Cherokee Nation Education Corporation, a nonprofit chartered under tribal law in 1998, received 501(c)(3) status from the IRS in 1998. After receiving 501(c)(3) status, the Cherokee Nation Education Corporation sent a letter to an IRS Exempt Specialist to request exemption from filing a Form 990. In February 1999, the Cherokee Nation Education Corporation received an IRS letter of determination that stated that it was exempt from filing a Form 990 because it was incorporated under tribal law.

<sup>2</sup> Letter of Mr. Thomas Miller (Chief, Exempt Organizations Project Branch 1, Internal Revenue Service) to Ms. Rebecca Adamson (President, First Nations Development Institute) (Sept. 8, 1998).

<sup>3</sup> Sample General Information Letter Regarding Instrumentalities (Exempt Organization Handbook), Internal Revenue Manual, MT-7151-51.

<sup>4</sup> The First Nations Letter applies the same analysis to the issue of whether grants to Indian tribal governments constitute “taxable expenditures” under Section 4945 of the Code and concludes that they do not.

# ADDITIONAL USES OF TRIBAL PHILANTHROPIC MODELS

The area of tax planning and economic development, particularly within Indian Country, is difficult and frequently unclear. Consequently, although the following information has been written in consultation with an attorney experienced in both tax and Indian law, any of the ideas contained in this booklet **should be discussed with an experienced attorney before being implemented by a tribe.** In addition, much of the information has also been taken from private letter rulings of the IRS. Private letter rulings explain IRS interpretations of specific circumstances; as such they should never be relied on as legal precedent, for circumstances may differ slightly from those that provoked the private letter ruling. However, a private letter ruling from the IRS can serve as a reliable guide.

## Tribal Governmental Programs Funded by Gaming Revenues Can be Used to Provide Tax-Free Benefits to Tribal Members

On May 30, 2002, the IRS released publication 3908 titled “Gaming Tax Law for Indian Tribal Governments.” The publication provides guidance to tribal governments on a number of tax-related issues, including withholding and reporting obligations applicable to per capita payments.

According to the Indian Gaming Regulations Act, net revenues from Class II and Class III gaming activities conducted or licensed by a tribe may be used to make per capita payments to members of the tribe. However, several conditions must be met to satisfy IRS law. For example, the per capita payments are subject to federal taxation, and the tribe, as the responsible party, must notify its members of such tax liability.

### Additional Uses of Tribal Philanthropic Models

- Use gaming revenues to provide benefits to tribal members that are not federally taxable, as per capita payouts are.
- Strengthen the credit rating of the tribe to the extent that an endowment provides a stable source of income.
- Improve the public perception of the tribe and improve public relations.
- Provide a responsible, long-term economic planning tool for tribal wealth.
- Support “civil society” in tribal communities.



Publication 3908 outlines several ways to provide **tax-exempt** benefits to tribal members using gaming revenues, however. The publication clarifies that payments authorized by a tribe for special purposes or programs, such as social welfare, medical assistance, or education, do not count as per capita payouts. Tribal governments can establish one or more governmental programs aimed at the social welfare of tribal members under which tax-free benefits may be provided to tribal members. The use of a foundation or other similar philanthropic organization can be used as a vehicle for delivering these programs to tribal members.

*The following material is taken from “**Tax Treatment of Tribal Governmental Benefits Programs,**” authored by Kathleen Nilles and Karen McAfee. According to Nilles and McAfee, the following programs generally may be offered to tribal members without triggering adverse tax consequences:*

#### **Educational Benefits Program**

In-kind educational benefits may be provided to tribal members without regard to financial need under an educational benefits program, including:

- A child development center to provide age-appropriate education for children from infancy to kindergarten.
- A tutoring program available to tribal youth and adult members to provide remedial instruction and assistance, such as assistance in obtaining high school general equivalency degrees.
- A summer youth program for children ages five to twelve who need care.
- The payment of room and board at certain residential living schools for tribal students with learning disabilities and other special needs.

#### **Scholarship Program**

In addition to providing in-kind educational programs and benefits, a tribe may wish to consider establishing a scholarship program, whereby the tribe could award cash scholarships for tuition and related expenses of tribal members at public and private schools, colleges, and universities. “Related expenses” include amounts paid for fees, books, supplies, and equipment required for courses of instruction.



### **Health Benefits Program**

Health benefits could be provided tax-free to tribal members without regard to financial need under a health benefits program, including the following medical services:

- Medical, dental, and vision insurance to enrolled tribal members and their spouses and children.
- Financial assistance with prescription drugs and/or medical, mental health, disease management, dental, and assisted living or nursing home services.
- Disease management services, which coordinate and support the treatment of individuals with chronic illness, such as congestive heart failure, coronary artery disease, chronic obstructive pulmonary disease, diabetes, and asthma.

In relation to the mental health of tribal members, the tribe could provide financial assistance with mental health services, including:

- Psychiatric and psychological assessment and diagnosis.
- Individual therapy.
- Family, marital, and group psychotherapy.
- Residential treatment programs for alcohol and substance abuse.
- Day treatment and residential treatment for individuals being treated for mental illness.

In addition, the tribe could establish a fitness and nutrition center for use by tribal members.

### **General Welfare Programs**

In general, payments made under the legislatively provided social benefits programs for the promotion of general welfare are excludible from the recipient's federally taxable income. To be considered general welfare payments, all payments made under a general welfare program must be based on "need," such as financial status, health, educational background or employment status, rather than being made available to all members of the tribe.

Although the IRS generally looks to the low-income guidelines of federal programs to determine whether need exists, the IRS does not use a strict rule to determine "need" for general welfare payments. The requisite amount of "need" also may be established where individuals are not necessarily within low-income guidelines of federal programs, but have extraordinary expenses (such as medical bills) to justify payments for their assistance.

Based on IRS private and published rulings, the following programs may be created as general welfare programs and funded by gaming revenue without adverse tax consequences (i.e. taxable income):

- **Economic Development Program:** The tribe may wish to consider establishing a business development program to encourage tribal members to own and operate business ventures on or near the reservation. Under this program, the tribe could make grants to tribal members to assist them in establishing new businesses. To ensure that the grants are tax-free to the recipients, the recipients should be required to demonstrate that they could not obtain financing from other sources.
- **Housing Assistance Program:** The tribe may wish to consider establishing a housing assistance program. This program could include both housing and mortgage assistance along with utility bills.
  - Housing assistance payments made to low-income members of an Indian tribe have been held by the IRS to be in the nature of general welfare payments and not includible in the recipient’s federally taxable income.
  - Mortgage assistance payments made under programs based on need have been held by the IRS to be in the nature of general welfare payments and not includible in the recipient’s federally taxable income.
  - Maintenance assistance payments made to low-income homeowners have been held by the IRS to be in the nature of general welfare payments and not includible in the recipient’s federally taxable income.
  - Utility assistance payments made by state governments to low-income elderly or disabled persons to reduce the costs of their winter utility bills have been held by the IRS to be in the nature of general welfare payments and not includible in the recipient’s federally taxable income.
- **Elders Assistance Program:** The tribe might wish to consider establishing an elders assistance program to provide financial assistance to certain low-income or disabled tribal elders. However, in order for payments under such a program to be tax-free, the program must be limited to tribal elders that demonstrate “need,” either by satisfying federal low-income guidelines or having extraordinary medical or other bills.

***Deferred Per Capita Plan***

To provide for the maintenance of tribal members in their old age or in the event of disability, the tribe may wish to consider establishing a deferred per capita benefit plan. Under such a plan, a tribal member could elect to defer some portion of his or her per capita benefits. The deferred amounts would be deposited in a so-called “rabbi” trust. The IRS has ruled privately that the amounts deferred under such a plan would not be subject to federal income tax until the year such payments are distributed or otherwise made available to the participants.

***Deferred Income Plan***

The tribe may also wish to consider creating a non-elective deferred income plan to provide a source of revenue for future needs of its members. Under this type of plan, the tribe would transfer property to a trust that would be held for the benefit of future tribal members. Provided that the trust is properly structured, amounts placed in the trust would not be currently taxable to tribal members. The IRS has ruled privately that amounts placed in a grantor-type trust would be tax-deferred.

***Spending Account Approach Not Viable***

In relation to benefits, it should be noted that a “spending account” approach to health, educational, and other similar benefits would not yield the same tax benefits for tribal members. In 1997, the IRS issued a technical advice memorandum to a tribe that distributed cash payments to tribal members for them to use (as they saw fit) on certain “governmental program” expenses, including education, health and medical care, and retirement programs. The tribal members were told that they could deduct any expenses for these or similar items from the otherwise taxable cash payments. The IRS determined, however, that the entire amount of the payments were taxable.

***Conclusion***

A tribe, through the above programs, would be able to provide vital services to its members. The methods outlined above would also provide savings in the form of reduced taxes for the tribe and its members.

### **Other Advantages of the Use of Philanthropic Models**

There are many other, less immediately apparent advantages to the use of tribal philanthropic models. For example, a tribal foundation can help responsibly manage tribal wealth, and at the same time play an important role in supporting the “civil society” of the local community. It can also be a valuable tool for public relations with non-Native communities. Tribal philanthropic models can offer the following advantages:

#### ***Increase Respect for the Tribe and Improve Public Relations***

Having a tribal philanthropic organization may improve public relations with the surrounding community and increase respect for the tribe. One example is the Forest County Potawatomi Community Foundation (described below), formed as a result of a state compact in Wisconsin. Since its creation, it has distributed several million dollars each year to inner-city Milwaukee and surrounding communities. This has greatly increased the status of the tribe in the local community, and has functioned as an important public relations tool for the Forest County Potawatomi casino.

#### ***Responsibly Manage Tribal Wealth***

Tribes with gaming operations understand that there is a need to diversify their economies and not rely on gaming as an exclusive or long-term solution to the economic challenges in Native communities. Many tribes are investing in other business opportunities in an attempt to better manage tribal economic development. Some tribes, such as the Eastern Band of Cherokee Indians, have used tribal funds to endow foundations to ensure that current day wealth will be available to future tribal members. By providing a financial vehicle for managing tribal wealth over the long term, tribal foundations and other philanthropic models offer a way to ensure that current tribal wealth will benefit the local community for generations to come.

#### ***Support “Civil Society” in the Local Community***

Tribal foundations can give grants that support local nonprofits providing services, meeting local needs, and promoting economic development. Not only do tribal foundations support social service provision, but they can also support diverse viewpoints in the local community. Many scholars of the nonprofit sector refer to this array of activities as “civil society.” The nonprofit sector often provides services or expresses viewpoints that the local government cannot, and in so doing is an important part of the social service safety net in many communities and also plays an important function in freedom of expression of diverse viewpoints.

# CONCLUSION

This paper was designed to be a general but thorough outline of options available to tribes or tribal members as they design their own philanthropic programs. A basic understanding of the types and status of a philanthropic model is important because no two are exactly the same. Each type of incorporation (state or tribal), tax status (501(c)(3) or 7871), and foundation classification (public charity/private foundation) has a particular mix of capabilities and restrictions unique to itself. This is not to say the commonalities between the formalized giving models are small or to imply individuals and groups should halt their thinking about philanthropy as a way to help Native communities if the type and status of the prospective model is not immediately apparent to them. Rather, the abundance of options for philanthropic models provides an opportunity for those interested in philanthropy to take their time in choosing the best models that suit their needs and meet their goals.



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