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TAX ANALYSTS®

viewpoint

American Indian Tribes And 401(k) Plans

by Erik M. Jensen

Erik M. Jensen is professor of law, Case Western Reserve University, Cleveland, Ohio. This article was written as part of an academic research project, with no remuneration coming from clients or other outside sources.

Tax Notes recently reported on a letter from Treasury Secretary Robert Rubin concluding that American Indian tribes are not entitled, under existing law, to establish 401(k) plans for their employees.[1] This is an issue that most readers of *Tax Notes* never will have to deal with, but the stakes are real for the affected tribes and their employees. Some tribes now have hugely successful businesses (such as gaming establishments), and they want to offer employees, both tribal members and others, benefits comparable to those available in the private sector.

Secretary Rubin and his advisers are wrong, as I shall demonstrate in this essay. With basic American Indian law principles imported into the analysis of relevant Internal Revenue Code provisions, it becomes clear that the code does not prohibit tribes from establishing 401(k) plans.

I proceed in three steps. The first section of the essay sets out the basic statutory framework. Section II discusses what I think is the real statutory construction issue, one that was not addressed in the Rubin letter. Finally, section III applies the canons of construction applicable in American Indian law to this particular issue. It is those canons, which were ignored by Secretary Rubin, that remove any doubt about the proper result.

[1]The letter, dated March 8, 1995, was sent to Sen. Ben Nighthorse Campbell, R-Colo., and was noted in *Tax Notes*, Apr. 3, 1995, p. 37. It is available electronically at *95 TNT 62-61*.

I. The Statutory Framework

Subject to some traditional rules in the Tax Reform Act of 1986, section 401(k) precludes a cash or deferred arrangement from qualifying under the statute if

> it is part of a plan maintained by —
>
> (i) a state or local government or political subdivision thereof, or any agency or instrumentality thereof, or
>
> (ii) any organization exempt from tax under this subtitle.[2]

The first exception doesn't apply to American Indian tribes. Tribes aren't states or local governments; they have a distinct constitutional status.[3] And Secretary Rubin quite properly conceded that nothing in the Internal Revenue Code requires treating tribes as if they were states for purposes of section 401(k). Section 7871 provides that tribes must be treated as states in the application of several enumerated code sections, but 401(k) isn't one of them.

Since tribes aren't states, Secretary Rubin instead relied on the second exception noted above: a tribe can't establish a 401(k) plan, he concluded, because it is an "organization exempt from tax under this subtitle."

II. The Real Interpretational Issue

The Rubin position has some superficial plausibility. It's true that tribes aren't subject to federal income tax;[4] they are indeed "exempt from tax." But that shouldn't be the end of the analysis. It's not at all obvious that tribes are "*organizations* exempt from tax" within the meaning of the statute.

[2]Section 401(k)(4)(B).

[3]Congress has the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, sec. 8, cl. 3; *see Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 18 (1831) (Marshall, C.J.) ("In this clause [tribes] are as clearly contradistinguished by a name appropriate to themselves, from foreign nations, as from the several states composing the union.").

[4]*See* Rev. Rul. 67-284, 1967-2 C.B. 55, 58 ("The tribe is not a taxable entity."); Felix S. Cohen's *Handbook of Federal Indian Law* 390 (1982). Query for the future: Should something like the tax on unrelated business income apply to tribal revenues that are insufficiently connected with core tribal functions?

Tribes are nations — not foreign nations, to be sure, but nations, as the Supreme Court recognized a long time ago.[5] The United States must deal with tribes on something approaching a government-to-government basis.[6]

Is the government of a nation an "organization"? Most people don't talk that way. I know that if I were drafting a statute, I'd pick some other term to refer to a governmental body.[7] I'd reserve use of "organization," particularly "organization exempt from tax," for nongovernmental entities.

Is the government of a nation an 'organization'? Most people don't talk that way.

Everyday usage might not be controlling on an interpretational issue like this, but neither is it irrelevant. It has particular value when elsewhere in the code the use of the terms "organization" and "government" is inconsistent. Indeed, the language in other code provisions points in diametric directions.

For example, section 457 contains the phrase "any other organization (other than a governmental unit) exempt from tax under this subtitle."[8] The parenthetical suggests that the term "organization" might include governments. On the other hand, section 42 — to pick one section somewhat arbitrarily — uses the terms "organization" and "government" in a more common sense way, as if they referred to different things.[9]

The best way to make some sense of the 401(k) exceptions is to read that section in conjunction with section 457. Section 457 permits "eligible employers" to establish unfunded deferred compensation plans without having to worry about constructive receipt issues. An "eligible employer" under section 457 is

> (A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and
>
> (B) any other organization (other than a governmental unit) exempt from tax under this subtitle.[10]

In short, eligible employers under section 457 generally are those that can't establish 401(k) plans.

The effect of the definition of "eligible employer," when coupled with the exceptions in section 401(k),[11] is to remove state and local governments and tax-exempt nongovernmental entities from the scope of 401(k) and put them into 457; those bodies can create unfunded, deferred compensation plans under section 457, but can't have 401(k) salary reduction plans. In general, assuming other statutory requirements are met, employers ought to fit within either section 401(k) or section 457, but not both.[12]

But Secretary Rubin's reading leaves American Indian tribes, which are made up of American citizens, out in the cold. A tribe clearly is a "governmental unit" other than a state or locality, so it's not an "eligible employer" under section 457. And Secretary Rubin concluded that 401(k) also is unavailable to a tribe.

In Secretary Rubin's defense, I must admit it doesn't help the case for tribal 401(k) plans that section 457 includes the parenthetical "other than a governmental unit" to qualify the word "organization," while the equivalent language in section 401(k) includes no such qualification.[13] Read narrowly, without regard to statutory purpose, the relevant language in both sections therefore can be interpreted to exclude American Indian tribes.[14] And one would like to think that Congress, in amending sections 401(k) and 457 in the Tax Reform Act of 1986,[15] carefully crafted the slightly different language in the two provisions with some overriding principle in mind.

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[5]*See Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 17 (1831) (Marshall, C.J.).

[6]*See Worcester v. Georgia*, 31 U.S. (6 Pet.) 515, 559-60 (1832). I use the qualifying language "approaching" because the Supreme Court has long characterized the tribes as "domestic dependent nations," requiring the protection of the United States. *See Cherokee Nation*, 30 U.S. at 17. It is now the case that tribes are subject to ultimate federal control under the so-called plenary power doctrine. *See generally* Nell Jessup Newton, "Federal Power Over Indians: Its Sources, Scope, and Limitations," 132 *U. Pa. L. Rev.* 195 (1984). At least in theory Congress can change the status of American Indian tribes — including terminating the tribes — in a way that it can't with foreign nations.

[7]In fact, I'm more inclined to think of "disorganization" when I think of government. *Cf.* Will Rogers' comment about the Democratic Party.

[8]Section 457(e)(1)(B).

[9]*E.g.*, sections 42(d)(2)(D)(ii)(III) ("any governmental unit or qualified nonprofit organization"); 42(i)(3)(E)(i) ("a State or local government or a qualified nonprofit organization"); 42(m)(1)(C)(v) ("participation by local tax-exempt organizations").

[10]Section 457(e)(1). In the Tax Reform Act of 1986, Congress added clause (B), for the following reason:

> Congress believed that it was inappropriate to apply constructive receipt principles to employees of nongovernmental tax-exempt entities, thereby precluding their ability to establish deferred compensation arrangements on a salary reduction basis, while permitting salary reductions for certain employees of governments and taxable entities.

1986 Bluebook at 653-54. At the same time, Congress added section 401(k)(4)(B), as quoted in the text accompanying note 2:

> The Act prohibits tax-exempt organizations and State and local governments (or a political subdivision of a State or local government) from establishing qualified cash or deferred arrangements.

1986 Bluebook at 642.

[11]As set out in the text accompanying note 2.

[12]It's not my purpose here to explore the differences between 401(k) and 457 plans — why, if it were entirely a matter of choice, an employer or a group of employees might prefer one type of plan over another.

[13]The Secretary didn't make this point, but he could have.

[14]I don't mean to suggest this is a necessary reading, but it is a possible one.

[15]*See supra* note 10.

One would like to think that, but I can see no such overriding principle. What purpose is served by making both 401(k) and 457 plans unavailable to tribes, even though one or the other is potentially available to most other employers? In particular, what is the reason for treating tribes less favorably than state and local governments? I don't know, and apparently Secretary Rubin doesn't either. He gave no policy justification for singling tribes out in this way, and in fact there's nothing in the legislative history of the 1986 changes to sections 401(k) and 457 that mentions tribes. Whatever Congress did in 1986, it didn't explicitly address the status of American Indian tribes. Congress therefore could not have mandated the result that Secretary Rubin said is required by the language of section 401(k).

On the basis of this statutory analysis, I have little difficulty in concluding that tribes may establish 401(k) plans. But I concede there's some uncertainty. The question then becomes: What's the effect of statutory ambiguity when American Indian tribes are involved?

III. Canons of Construction in American Indian Law

In fact, there's a lot of learning and authority, including a well-developed set of canons of construction, on how to deal with ambiguity in American Indian law. In general, the canons have been described as follows: "(1) very liberal construction to determine whether Indian rights exist, and (2) very strict construction to determine whether Indian rights are to be abridged or abrogated."[16] Congress has the power to limit tribal prerogatives, but it must do so unequivocally. If there's doubt about the language in a treaty, a statute, or a regulation, the doubt must be resolved in a way favorable to the affected tribe. It would not be overstating matters much to say that in such circumstances, the tribe's position prevails.

Secretary Rubin made no reference to the applicable canons, and that's a fatal flaw in his analysis. Applying the canons is not a matter of secretarial discretion.[17] Yes, the 401(k) issue is not a typical "Indian rights" question: it has little or nothing to do with traditional tribal rights, and it affects tribes more in their capacities as employers than it does in their capacities as sovereigns. But a fundamental issue remains: whether tribes should be treated less generously for federal income tax purposes than other bodies, including other American governmental bodies. Without a specific, unequivocal congressional directive on the matter — and surely use of the phrase "organization exempt from tax" is not that — the answer must be "no."

* * * * *

The Rubin letter noted that, if it had been enacted, legislation introduced in the last Congress (H.R. 3419) would have had the effect of permitting tribes to establish 401(k) plans, and Congress can act now to get that result. That's a straightforward way to do away with the interpretational problem, and the secretary expressed support for such a change.[18] But Congress shouldn't have to act to "restore" tribal powers that never were taken away.

[16]David H. Getches et al., *Federal Indian Law: Cases and Materials* 348 (3d ed. 1993).

[17]Quite the contrary. As a trustee for the tribes — the "domestic *dependent* nations," *see supra* note 6 — the federal government has the obligation to protect tribal interests.

[18]"We should be very interested in working with you [Sen. Campbell] on expanding the availability of section 401(k) plans to tribal government employees."

The Role of ETIs in Pension Investments — Implications of H.R. 1594 and S. 774

by Stanley G. Oshinsky

This article appeared in the June 19 issue of *Tax Notes* with a typographical error. The article is based on a presentation delivered at the Annual Chief Pension Officers Meeting of the American Council of Life Insurance in Washington on June 13. The author is an attorney currently working on Capitol Hill.

For years, private and public pension plans have invested billions of dollars back into their local communities in what are termed "economically targeted investments" (ETIs). Now, a bill introduced in the House and the Senate, as H.R. 1594 and S. 774, respectively, would place new restrictions on the powers of pension fund investment advisers to make ETIs. The bill is championed by Rep. Jim Saxton, R-N.J., and endorsed by the House Republican leadership. The rationale for introducing this bill is a perception that the solvency of the $4.8 trillion retirement system is at risk due to ETIs.

> ***If the bill is enacted, a Department of Labor interpretative bulletin and 15 years of DOL advisory opinions allowing ETIs would be nullified.***

If the bill is enacted, a Department of Labor interpretative bulletin and 15 years of DOL advisory opinions allowing ETIs would be nullified. The DOL has consistently ruled that investment advisers are permitted to consider the collateral benefits of an investment, when choosing between investments that have comparable risks and comparable expected rates of return. These benefits include whether the investment promotes economic growth, job creation, or infrastructure development. If the bill is enacted, investment advisers of private pension funds would potentially violate federal law and be held personally liable for any ETIs they finance.