

THE BOND BUYER

Fed economists outline constraints to tribal access to tax-exempt market

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Ahead of an expected push to broaden tax-exempt financing authority for tribal governments next year, a pair of Federal Reserve Bank of Minneapolis economists are examining how the tax code could be reformed to allow tribes greater access to the financing tool.

An April 25 [paper titled "Tax code constraints limit tribal tax-exempt bonding"](#) notes the relatively anemic amount of tax-exempt bonds issued by tribes compared to state and local governments, and notes that expanded capital access could "enhance tribal governments' ability to accelerate economic prosperity, and grow their private sectors."

Citing the Congressional Budget Office, the paper estimates the cost of allowing tribes more access to tax-exempt bonds would cost around \$77 billion over 10 years.

"I think they're absolutely right," said Randy DeFranco, a partner at Holland & Knight who specializes in tribal finance. Tribes "are definitely not on equal footing with municipalities, and they'd like to get on equal footing."



Randy DeFranco, partner in Holland & Knight who specializes in tribal finance, said tribal governments are not on equal footing with states and cities when it comes to access to the tax-exempt market. *Holland & Knight*

The biggest obstacle to tribal access to the tax-exempt market is the so-called essential government function test, or Section 7871, which prohibits tribes from issuing tax-exempt bonds for projects that are not customarily performed by state and local governments. State and local issuers have no such provision attached to their bonds, and often tap tax-exempt debt to finance revenue-generating projects, such as convention centers and stadiums, despite being outside the scope of an "essential government function."

Tribes are also restricted from issuing private activity bonds, with narrow exceptions.

"Because these project-specific revenue bonds can be unavailable to tribes, tribes have limited access to what can be an efficient way to service debt since the projects pay for themselves," said the paper's authors Matthew Gregg, senior economist at the Center for Indian Country Development, and John Morseau, senior policy analyst at the Center for Indian Country Development at the Minneapolis Fed.

The authors estimate that between 2003 and 2010, annual per capita tax-exempt bond proceeds by state and local governments were "roughly five times higher than annual per capita tax-exempt bond proceeds by tribal governments for tribal citizens," and that from 1987 to 2010, tribal tax-exempt bonds "rarely surpassed one-fifth of 1% in any given year, which is "well below" the estimated tribal population of 1.5% of the U.S. population over the same period.

Post-2010 per-capita data is difficult to analyze in part because much of the tribal debt financing occurs in the private markets, said the authors, who recommended more complete tribal bond data be made available.

There are 574 federally recognized individual tribes as of 2024.

Tribal advocates hope that Congress will take up expanded tribal access to the tax-exempt market next year as the U.S. tax code takes center stage amid the expiring Tax Cuts and Jobs Act.

DelFranco, who was attending this week's Native American Finance Officers Association conference, noted that a Monday afternoon panel was devoted to potential new tax legislation, with a focus on "specific efforts to achieve tribal bonding parity and the benefits of increasing access to bond financing." The paper's author John Morseau was one of the panelists.

In 2021, [a draft reconciliation bill in Congress](#) included legislation that eliminated the essential government function test and replaced it with a new Section 7871(c), which would have put native tribes and states on a similar playing field.

The provision stalled, but DelFranco said he expects a renewed push.

Another possibility would be to lift or renew the [volume cap on Tribal Economic Development Bonds](#), DelFranco said. Created after the Great Recession as part of the American Recovery and Reinvestment Act, the legislation temporarily removed the requirement that tribal bonds only be used to finance "essential

governmental function" projects — though the projects had to be on reservations and could not involve gambling — with a cap of \$2 billion.

"There will be an attempt to put some kind of tribal tax provisions" in a larger tax vehicle, whether it's removing or amending the essential government function test or re-upping TEDs volume cap, DeFranco said.

The new Fed paper will "heighten people's awareness of the issue," he added.