

ITG News
Keeping First Nations Informed

Publication 4267-C
Catalog Number 37830C Great Lakes Edition October 2006

In This Issue

Message from the Director
Revisions to Publication 3908 and Publication 4268
Excise Tax on Abusive Transactions
Advance Rulemaking on Essential Government Functions for Bond Issuance
ITG and Justice Work to Shut Down Abusive Scheme
Pension Bill Affects Indian Tribal Government Plans
Risk-based Compliance Programs
Before you file Forms 1099 and W-2G
ITG Area Contacts
Avoid Tribal Credit Card Abuses
Tax Calendar of Events

Message from the Director

As we begin the start of the federal government's 2007 fiscal year, our office is undertaking our annual Customer Satisfaction Survey. This is our fourth year for the survey, which is a valuable tool that helps us better understand the federal tax administration needs of Indian tribal governments.

I want to take this opportunity to communicate how strongly I feel about the survey and how important the results are in the formulation of future activities. Our initial survey in 2003 showed a strong overall level of satisfaction but clearly demonstrated some differences between geographic areas. We were able to follow-up and determine that the feedback from those tribes related primarily to problems involving accessibility of information, and we developed alternative means of service delivery to meet their needs.

Our second annual survey in 2004 yielded feedback that related to the lack of adequate ITG staffing in the Pacific Northwest and navigational confusion with the landing page of our web site. We were able to address the staffing concern by hiring two additional ITG Specialists in Washington and Alaska, as well as relocating the area manager to Portland as the opportunity arose. We worked diligently to reconfigure the entire structure of our web site to make it easier to locate needed information and more easily navigate between pages. The

feedback from the 2004 survey started that process, and the Advisory Committee to the TEGE Commissioner helped us through the process by contributing suggestions and providing feedback on proposed changes.

The 2005 Survey showed concerns about penalties and, in particular, a need for ITG to do more to assist tribes in mitigating them. In response, we created “Helpful Hints to Avoid Penalties” and posted it on our web site. The survey results also expressed a need for the IRS to do more to assist on tribal member issues, and we are currently developing a “primer” to help individuals, tax practitioners, and IRS employees better understand many of the unique federal tax issues that affect tribal members.

The 2006 Customer Satisfaction Survey was mailed to each tribe in late September. If you received it, I urge you to complete and return it in the postpaid envelope as soon as possible. All responses are anonymous unless you choose to identify yourself, but your feedback is invaluable to us. As always, we will publish a summary of the results as well as a listing of activities we will undertake to further improve our performance. I want to thank everyone in advance for their participation in this vital process.

Christie Jacobs

Revisions to Publication 3908 and Publication 4268

The Office of Indian Tribal Governments has updated Publication 3908 – Gaming Tax Law and Bank Secrecy Act Issues for Indian Tribal Governments. The revised issuance contains updated information on withholding rules and tip compliance and greatly expanded information on the Bank Secrecy Act regulations that impact tribal casinos. The new revision, dated August 2006, can be accessed on-line through our web site at www.irs.gov/tribes, or hard copies can be ordered from the IRS Distribution Center by calling 1-800-829-3676.

We have also updated Publication 4268, the Employment Tax Desk Guide for Indian Tribal Governments. This extensive guide is only available through a download from our web site at www.irs.gov/tribes, but we will provide a copy for your use on a CD-Rom upon request if you contact your local ITG Specialist.

Excise Tax on Abusive Transactions

Although it is rare, the IRS has encountered situations where Indian tribes and other non-tax entities have become involved in tax shelter transactions. One of the major inducements was that a non-tax entity bore little risk, since they did not file an income tax return where their participation had to be disclosed, and there

was no penalty for their participation/facilitation. This concern was recently addressed by Congress in the enactment of section 4965 and related provisions which were signed into law May 17, 2006. This section imposes disclosure rules, taxes, and penalties with respect to non-tax entity participation in prohibited tax shelter transactions. While the impact and rules relating to these new provisions are still evolving, Tribes need to be aware that there is now a major risk to participating in tax shelters.

The new provisions require non-tax entities (broadly defined to include employee plans, other deferred compensation and retirement plans including self-directed IRAs, and governmental units as well as exempt organizations) to report to the IRS their participation in any prohibited tax shelter transaction and the identity of other parties to the transaction. A new penalty under section 6652(c)(3) applies to the non-tax entity for failure to make the required disclosure. The IRS may make a written demand for the disclosure, and an additional penalty applies for failure to comply.

Non-tax entities described in section 501(c) and (d), governmental entities described in section 170(c), and Indian tribal governments must also pay excise taxes imposed by new section 4965. The tax is increased if the entity knew or had reason to know that the transaction was prohibited. "Entity managers" that approve the participation must also pay a tax if they knew better (or had reason to know). Under new section 6011(g), taxable parties to the transaction must disclose to the participating tax-exempt entity that the transaction is a prohibited tax shelter transaction. Prohibited tax shelter transactions are listed transactions under section 6707A(c)(2), and confidential transactions, and transactions with contractual protection that are reportable transactions under section 6707A(c)(1). The effective date imposes excise tax on income or proceeds allocable to periods after August 15, 2006.

If you are contacted by a promoter encouraging your participation in a scheme that appears highly questionable, you should first seek a clear prospectus of the transaction and, also, ask yourself if the specific investment is the type of enterprise customary to a government. If you believe the venture is suspect, please contact ITG via e-mail at tege.itg.schemes@irs.gov or via mail at IRS-Indian Tribal Governments, Box 227, Buffalo, New York 14225.

Treasury Issues Advance Notice of Proposed Rulemaking
on Definition of Essential Governmental Function for
Indian Tribal Governments under Section 7871

The Department of the Treasury and IRS Counsel has issued an Advanced Notice of Proposed Rulemaking that applies to Indian Tribal governments and to State and local governments that issue bonds for the benefit of Indian tribal

governments. This proposed rule addresses the definition of an "essential governmental function" under section 7871(c) of the Internal Revenue Code and the limitation of that term to activities customarily performed by State and local governments for purposes of section 7871(e) of the Internal Revenue Code. The IRS has become aware of an increasing number of instances in which taxpayers have raised questions about the application of section 7871(e). Accordingly, the Treasury Department and the IRS have determined to seek public comment in advance of drafting proposed regulations in this area. Public comments may be made regarding the proposed standard, as outlined at the end of this article.

Section 7871(a)(4) of the Internal Revenue Code of 1986 provides that an Indian tribal government is to be treated as a State "subject to subsection (c), for purposes of section 103 (relating to State and local bonds)." Section 7871(c)(1) provides that "section 103(a) shall apply to any obligation (not described in paragraph (2)) issued by an Indian tribal government (or subdivision thereof) only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function." Section 7871(e) provides that "for purposes of this section, the term 'essential governmental function' shall not include any function which is not customarily performed by State and local governments with general taxing powers."

The Treasury Department and the IRS anticipate that the proposed regulations will provide that for purposes of section 7871(c) and section 7871(e), an activity will be considered an essential governmental function that is customarily performed by State and local governments if: (1) there are numerous State and local governments with general taxing powers that have been conducting the activity and financing it with tax-exempt governmental bonds, (2) State and local governments with general taxing powers have been conducting the activity and financing it with tax-exempt governmental bonds for many years, and (3) the activity is not a commercial or industrial activity. The proposed regulations will further provide that examples of activities customarily performed by State and local governments include, but are not limited to, public works projects such as roads, schools, and government buildings.

Before the notice of proposed rulemaking is issued, consideration will be given to any written comments that are submitted timely (preferably a signed original and eight (8) copies) to the IRS. All comments will be available for public inspection and copying.

Written or electronic comments must be submitted by November 7, 2006, to:

Internal Revenue Service
PO Box 7604
CC:PA:LPD:PR (REG-118788-06) Room 5203
Ben Franklin Station
Washington, DC 20044

Submissions may be sent electronically, via the IRS Internet site at <http://www.irs.gov/regs> or via the Federal e-Rulemaking Portal at <http://www.regulations.gov> (indicate IRS and REG-118788-06).

ITG and Justice Work to Shut Down an Abusive Scheme

ITG continues to pursue promoters of abusive schemes that not only are contrary to federal tax law, but also often deprive tribes and tribal members of the financial resources from gaming and other tribal economic ventures. A recent example of these efforts surfaced in early August when the Department of Justice filed suit against two accountants for allegedly running a fraudulent scheme involving improper deferrals of per capita distributions from casino gaming profits. The lawsuit alleges that the accountants, Kenneth Sorenson and Stephen Drake, received significant fees from members of a tribe who participated in the alleged scheme.

The lawsuit seeks a permanent order to halt Drake and Sorenson from continuing to execute their "tax deferral plan." The suit notes that they are officers of Benecorp LLC, a company devoted to providing financial counseling to Native American tribes and members. The tax plan, which they currently call CapNet 7, has been promoted within Indian country since at least 2003. While it had been heavily marketed in articles written for magazines and at trade shows in Las Vegas and Palm Springs, few tribes had expressed interest. Drake is reportedly a "silver member" of the California Nations Indian Gaming Association, which may have helped him gain access and credibility for the program.

The Justice Department lawsuit states that the Benecorp scheme used "sham entities and sham transactions" to create a circular flow of funds. The tribe involved has cooperated with the IRS during the investigation.

If you are aware of similar potentially abusive schemes, please contact ITG either via e-mail at tege.itg.schemes@irs.gov or by writing to us at:

IRS – Indian Tribal Governments
Box 227
Buffalo, New York 14225

Reporting Abuses/Schemes

We continue to work with tribes and tribal officials to address financial abuses and schemes being promoted in Indian country. Working together can help ensure the integrity of tribal finances, and eliminate the threats posed by individuals with schemes that appear "too good to be true" and often are.

If you are aware of financial impropriety or of a promoter advocating a scheme that appears highly suspect, you can contact the ITG Abuse Detection and Prevention Team at (716) 686-4860 or via e-mail at tege.itg.schemes@irs.gov

Pension Bill Affects Indian Tribal Government Plans

As many of you may be aware, there has been ongoing disagreement over the need for Tribes to file Form 5500 for their pension and retirement plans. While existing law exempted “governmental plans” from filing, the law did not include tribes in the definition of that term in the pension statute. There were ongoing attempts to remedy the matter by seeking to expand the definition to include Indian Tribal governments. In the interim, the IRS made an administrative decision to forego significant enforcement action pending clarification by Congress.

The issue was recently addressed as part of the major pension reform bill that President Bush signed into law in August. Although most Tribes were seeking to obtain full parity with other governmental entities, the final legislation added a limitation on tribal entities by stating that the term “governmental plan” includes a plan which is established and maintained by an Indian tribal government, a subdivision of an Indian tribal government, or an agency or instrumentality of either, and all of the participants of which are employees of such entity substantially all of whose services as such an employee are in the performance of essential governmental functions but not in the performance of commercial activities_(whether or not an essential government function).

This limitation was not anticipated but appears to require the filing of Form 5500 for plans that include any employees involved in casinos or other commercial enterprises.

The IRS is analyzing the overall pension bill. We will continue to post updated information on our web site at www.irs.gov/tribes. Our overall goal is to keep tribal employees covered and transition plans into compliance with new rules.

Self-Assess Your Federal Tax Compliance Risks

Tribal entities can now self-assess their federal tax compliance and work with ITG to address any problems they uncover. Entities electing to participate receive a fillable template from ITG, and are provided with the name of a local ITG Specialist who will serve as their resource during the process.

Information on the program, as well as an on-line request form, is available through the “Enhancing Federal Tax Compliance” link on the right-hand of the ITG web site landing page at www.irs.gov/tribes, or you can make an inquiry

about the program via e-mail to tege.itg.tefac@irs.gov.

Risk-based Compliance Programs

Under Title 31, every casino is required to develop, implement, and maintain an “effective” anti-money laundering program that is reasonably designed to assure and monitor compliance with the Bank Secrecy Act. It must be written and focus on specific risk factors identified at each facility.

At a minimum, each program should include:

- A system of internal controls to assure ongoing compliance;
- Internal and/or external compliance testing;
- Training of casino personnel, including training in the identification of unusual or suspicious transactions;
- A designated Compliance Officer who can assure day-to-day compliance;
- Procedures for using ALL available information to determine adequate verification of the identity of persons involved in a reportable or a suspicious transaction;
- Procedures designed to detect transactions or patterns of transactions required to be reported; and
- The use of computers and automated programs to aid in assuring compliance.

Failure to implement an adequate AML program could result in a referral to FinCEN and the risk of potential civil penalties of up to \$25,000 per day. A BSA Examination by IRS revenue agents would include an analysis of your program to identify the strengths and weaknesses of your AML program and measures the risk of money laundering and terrorist financing posed by the products and services offered by your casino. How does your AML Compliance Program measure up?

Employee Tip Income Program Questions

ITG has a full-time Tip Coordinator to assist you with any questions about tip reporting agreements. If you are interested in securing a Tip Agreement, have questions concerning your existing agreement, or have received a notice about tip reporting responsibilities that is unclear, please contact Julie Reese at (303) 231-5250, ext. 236.

Suggestions

Do you have a topic you would like to see covered in a future issue of ITG News? Is there someone you know who would like to receive their own copy of ITG News? If so, please contact Sandy King at Sandra.King@irs.gov or (906) 635-9389.

Before you file those 1099's and W-2G's

Have you resolved all your TIN/name mismatch notice problems yet? Do you know what is required in order to avoid mismatch penalties in the future? Although information return filing and mismatch penalties have been topics of discussion in this newsletter several times, here is one more pre-filing tip that you can plan now that may help you avoid problems in the future.

Check your 1099/W-2G data before you file those returns. Run a report with a "sort" by social security number (or TIN) to look for numbers that have more than one name associated with them. Then, run those reports again with a "sort" by name—do you have any names on that list that are filed under with than one TIN? Is there a difference in TIN that could be attributed to an input error or a transposed number? Are there any transactions with no TIN, or an obviously improper TIN?

When discrepancies are identified from these reports, you now have time to resolve those differences before the information returns are due. Double-check the information obtained from the customer at the time of the transaction--do you have copies of documents in your files that can resolve the difference? Can you contact the customer to request a confirmation of the proper information?

Along with proper identifying procedures at the time of the transaction and proper follow-up procedures when you've been notified by IRS of a potential mismatch, attempting to resolve a problem before filing can help you establish a reasonable basis for waiver of a mismatch penalty...and perhaps reduce or even eliminate the notices altogether!

ITG Area Contacts
Great Lakes Area
Michigan, Minnesota, Wisconsin

John Walters, Manager
Fargo, ND
701-239-5400
John.L.Waters@irs.gov

Stan Wiatros, Specialist
St. Paul, MN
651-312-7732
Stanley.J.Wiatros@irs.gov

Rick Ziton, Specialist
St. Paul, MN
651-312-7734
Richard.J.Zilton@irs.gov

Sandy King, Specialist
Sault Ste. Marie, MI
906-635-9389
Sandra.King@irs.gov

Telephone, Internet, & Mailing Address

Call: Customer Account Services (Toll free) 877-829-5500

Visit: Indian Tribal Governments at www.irs.gov/tribes

Write: Internal Revenue Service
Indian Tribal Governments SE:T:GE:ITG
1111 Constitution Ave., NW
Washington, DC 20224

Avoid Tribal Credit Card Abuses By Creating Effective Internal Controls

As tribes continue to develop their economies and they find an increased need to have employees travel on tribal business, they need to create and maintain effective internal controls over tribal charge cards and travel reimbursement programs.

The initial step is to determine the authority granted to employees to use tribal charge cards. Many tribes have issued credit cards to the tribal council members and key operating officials of tribal enterprises. Generally the tribal finance office receives the credit card invoices and directly pays the expenses. This allows the tribal official to avoid carrying large sums of cash or traveler's checks or having to use a personal charge card. Such processes are common, but tribes should carefully control the distribution of cards that are in the name of the tribe/tribal entity and the level of authority granted to those who have them in their possession. It is a general practice to issue such cards only to those individuals who travel on a regular basis on behalf of the tribe.

The second, and most crucial step, is the establishment of "accountability" for the expenses. The fact that the tribe/tribal entity may be directly billed for the expenses of the individual and pays such expenses on their behalf does not eliminate the need for the individual to properly document the purpose of the expense. Controls are needed to ensure that:

expense reports are filed,
actual receipts are provided that match each charged expense, and
the business purpose for the expense is clearly established.

The expense reports should be reviewed by an independent party within the administration to maximize the integrity of the process. Any issues that cannot be resolved by the individual making the charge must be brought to the attention of tribal finance officials. Amounts which are not properly documented as being directly related to official tribal business will constitute taxable income to the individual and must be reported as such on Form W-2 for the employee at the close of the calendar year.

While most tribes follow strict procedures that meet or exceed these

requirements, cases have surfaced where there have been abuses. These cases have involved personal use of tribal charge cards as well as situations where the tribe has paid an expense twice – once as a directly billed cost on a tribal card charge and again as a payment to the individual through an advance or expense report that was never reconciled to the charge card bills.

We encourage every tribe that allows employees or officials the use of charge cards issued in the name of the tribe, to conduct a periodic review of their procedures to ensure that adequate internal controls are in place. Your ITG Specialist is available to assist in that process or to address any questions you may have regarding the potential tax consequences of inappropriate charge card use. Working together, we can eliminate potential problems and better protect tribal revenues for the benefit of members and tribal programs.

Federal Tax Calendar for Fourth Quarter 2006

October 2006

October 4th, Wednesday - *Make a deposit for 9/27 – 9/30

October 6th, Friday - *Make a deposit for 10/1 – 10/3

October 10th, Tuesday - Employees report September tip income to employer if \$20 or more

October 12th, Thursday - *Make a deposit for 10/4 – 10/6

October 13th, Friday - *Make a deposit for 10/7 – 10/10

October 16th, Monday - **Make a deposit for September if under the monthly deposit rule

October 18th, Wednesday - *Make a deposit for 10/13

October 20th, Friday - *Make a deposit for 10/14 – 10/17

October 25th, Wednesday - *Make a deposit for 10/18 – 10/20

October 27th, Friday - *Make a deposit for 10/21 – 10/24

November 2006

November 1st, Wednesday - *Make a deposit for 10/25 – 10/27

November 3rd, Friday - *Make a deposit for 10/28 – 10/31

November 8th, Wednesday - *Make a deposit for 11/1 – 11/3

November 13th, Monday - *Make a deposit for 11/4 – 11/7. Also, Employees report October tip income to employers if \$20 or more

November 15th, Wednesday - *Make a deposit for 11/8 – 11/10. Also, **Make a deposit for October if under the monthly deposit rule.

November 17th, Friday - *Make a deposit for 11/11 – 11/14

November 22nd, Wednesday - *Make a deposit for 11/15 – 11/24

November 27th, Monday - *Make a deposit for 11/18 -11/21

November 29th, Wednesday - *Make a deposit for 11/22 – 11/24

December 2006

December 1st, Friday - *Make a deposit for 11/25 – 11/28

December 6th, Wednesday - *Make a deposit for 11/29 – 12/1

December 8th, Friday - *Make a deposit for 12/2 – 12/5

December 11th, Monday – Employees report November tip income to employers if \$20 or more

December 13th, Wednesday - *Make a deposit for 12/6 – 12/8

December 15th, Friday - *Make a deposit for 12/9 – 12/12. Also, **Make a deposit for November if under the monthly deposit rule.

December 20th, Wednesday - *Make a deposit for 12/13 – 12/15

December 22nd, Friday - *Make a deposit for 12/16 – 12/19

December 28th, Thursday] - *Make a deposit for 12/20 – 12/22

December 29th, Friday - *Make a deposit for 12/23 – 12/26

*= Make a Payroll Deposit if you are under the semi-weekly deposit rule.

**= Make a Monthly Deposit if you qualify under that rule.

NOTE: Deposits made through EFTPS must be initiated at least one day prior to the due dates listed above in order to be timely.

Return Filing Dates

October 31st

File Form 941 for the 3rd quarter of 2006. If all deposits paid on time and in full, file by November 13th.

File Form 730 and pay the tax on applicable wagers accepted during September.

November 30th

File Form 730 and pay the tax on applicable wagers accepted during October.

January 2nd, 2007

File Form 730 and pay the tax on applicable wagers accepted during November.
