

# ENVIRONMENTAL FINANCIAL ADVISORY BOARD

JUL 26 2012

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Honorable Lisa P. Jackson  
Administrator  
U.S. Environmental Protection Agency  
Washington, DC 20460

Dear Administrator Jackson:

Since April 2011, EPA's Environmental Financial Advisory Board (EFAB) has been working on a charge from EPA's Office of International and Tribal Affairs (OITA) to identify options for developing sustainable funding of tribal environmental programs. OITA has also requested EFAB's support to identify options for developing sustainable funding of tribal environmental projects. Specifically, in both charges, the agency has asked EFAB to comment on whether financial barriers exist, and if so, to identify mitigation options to minimize or remove such barriers.

Although EFAB has not completed either assignment, the Board has become aware of a significant barrier regarding funding of tribal environmental projects that warrants timely response on the part of EPA. Under the current federal Tax Code, as enforced by the Internal Revenue Service (IRS), tribal governments may be denied access to the tax-exempt municipal bond markets under the following two situations:

1. **Restricted Issuance Criteria for Governmental Debt.** The first mechanism under which this denial can occur is known as the "essential government function" standard, a subjective criterion which restricts tribal issuance of governmental debt relative to the issuance privileges accorded state and local governments. While there is no statutory definition of "essential government function," it has been interpreted as limiting tribal flexibility in how services are provided and to whom. In contrast, state and local jurisdictions are permitted to issue tax-exempt bonds if *either* of the following tests is met:

- (1) No more than 10 percent of bond proceeds are used for private use; *or*
- (2) No more than 10 percent of bond proceeds is payable or secured from payments or property used for private use.

Under the above two-part test, state and local governmental debt is more readily quantifiable and able to be more easily administered than the "essential

governmental function” standard imposed on tribal governments. In addition, the state and local government test also permits the issuance of governmental debt for private purposes, a privilege not accorded to tribal governments.

2. **Prohibition of Tribal Issuance of Tax-Exempt Bonds.** A second borrowing restriction facing tribal governments is the federal prohibition of tribal issuance of private activity bonds. By contrast, state and local governments are permitted to issue private activity bonds to finance a wide array of improvements including many functions of interest to EPA such as water and sewage facilities, solid waste disposal facilities, local district heating and cooling facilities, environmental enhancements to hydroelectric generating facilities, and qualified green buildings and sustainable design projects. Typically, private activity bonds are repaid by payments such as usage fees, rather than through general tax revenues. In general, the ability to place to private activity bonds affords governments a wider, diversified portfolio of financing options, as well as increased financial flexibility.

The EFAB has been made aware of at least two western tribes whose tax-exempt water treatment facility bonds were challenged by the IRS due to these financing restrictions. In each instance, the tribes were providing capacity to both residential and nonresidential users in order to achieve efficient sizes for the facilities; however, this approach exceeded the tribe’s “essential governmental function” of providing water solely for tribal consumption. It is likely that bonds for such facilities would not have been challenged if issued by state or local governments.

As the Board understands, in December 2011, the Treasury Department sent to Congress a Report and Recommendations regarding the Tribal Economic Development Bond provision under Section 7871 of the Internal Revenue Code. In this report, the Treasury Department made four recommendations that are relevant to EFAB’s charge from OITA:

- (1) For reasons of “tax parity, fairness, flexibility, and administrability,” Congress should “adopt the State or local government standard for tax-exempt governmental bonds ... on a permanent basis for purposes of Indian tribal governmental eligibility to issue tax-exempt governmental bonds.”
- (2) “The essential governmental function standard for Indian tribal governmental tax-exempt bond financing under Section 7871 (c)” should be repealed.
- (3) Congress should “allow Indian tribal governments to issue tax-exempt private activity bonds for the same types of projects and activities as are allowed for State and local governments.”
- (4) Congress should allow Indian tribal governments to issue or use tax-exempt bonds to finance projects that are located on Indian reservations, together with projects that both: (i) are contiguous to, within reasonable proximity of, or have a substantial connection to an Indian reservation; and (ii) provide goods or services to resident populations of Indian reservations.

As an interim step in completing the work that OITA has requested of us, the Board has concluded that the Treasury Department recommendations will eliminate a barrier currently experienced by tribes on financing environmental projects. We agree with Treasury's conclusions that further work is needed to address the credit challenges that tribal governments face with regard to accessing the tax-exempt bond market.

We believe that the proposed recommendations are appropriate from the perspective of ensuring tax parity among tribes, states, and municipalities. If adopted, these recommendations can increase the supply of capital for tribal environmental projects and support economic development in locations with extremely high unemployment rates.

The Board recommends that EPA express its support for the Treasury Department's proposed changes in the tax law.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Shapiro". The signature is fluid and cursive, written in a professional style.

Michael Shapiro  
Designated Federal Official

cc: Bob Perciasepe  
Deputy Administrator

Michelle DePass, Assistant Administrator  
Office of International and Tribal Affairs

Barbara Bennett  
Chief Financial Officer



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

SEP 28 2012

OFFICE OF  
INTERNATIONAL AND  
TRIBAL AFFAIRS

**MEMORANDUM**

**SUBJECT:** Eliminating Barriers to Tribal Environmental Projects

**FROM:** Michael Stahl, Acting Assistant Administrator  
Office of International and Tribal Affairs

**TO:** Michael Shapiro, Designated Federal Official  
Environmental Finance and Advisory Board

I express my gratitude to you, Barb Bennett, and the Environmental Finance Advisory Board (EFAB) for taking on the request from OITA to identify options for developing sustainable funding of tribal environmental programs.

I also appreciate the time and effort spent researching innovative ways to remove significant financial barriers for tribes developing and implementing their own environmental programs. The EFAB has recommended an immediate action that EPA express its support for the Treasury Department's proposed changes in the tax law, and OITA strongly concurs.

Federal Agencies work with tribal governments on government-to-government basis. With that in mind, agencies should seek to eliminate financial barriers for tribes and create as much parity as possible for tribal governments issuing tax-exempt bonds to finance environmental projects on Indian reservations, are contiguous to, or have a substantial connection to an Indian reservation.

Again, thank you for the time and effort EFAB spent on this critical issue, and my Office of International and Tribal Affairs looks forward to continued engagement and support on this important effort.

cc: Barbara Bennett  
Chief Financial Officer