HONORING NATIONS: 2005 HONOREE

Navajo Nation Sales Tax
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Navajo Nation

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The Navajo Nation is the largest coal-producing tribe in the U.S. and, historically, its government has relied on tax and royalty revenue associated with coal production as a primary source of revenue. Today, however, both depletion and a desire to lessen the Nation's dependence on income from non-renewable resources have led the Navajo Nation to consider new ways to generate revenue for governmental operations. In 2002, it began levying the first comprehensive Native nation sales tax on goods and services sold within reservation boundaries. By law, revenue from the tax is earmarked for the Nation's Permanent Trust Fund, land acquisition, and local government, among other uses, before the remainder flows to the nation's General Fund.

Coal mining and oil and natural gas extraction annually produce approximately $89 million for the Navajo Nation. But since this income stream is derived from non-renewable natural resources, it is ultimately unsustainable. By the late 1990s, the Nation knew that in little more than a decade, several of its mines were likely to close, greatly reducing tribal government revenues.

At the same time, the Navajo Nation government was anticipating new demands on its financial resources. In 1998, the Navajo Nation Tribal Council passed the Local Governance Act (LGA), empowering local governments. Since the Nation is so large (it has five agencies, which are similar to U.S. states, and 110 chapters, which are similar to counties or municipalities) and, at the local level, relatively diverse, it made organizational and cultural sense for the central government to devolve authority over local matters to the chapters. While the transfer in decision-making power was not immediate, chapters first had to go through a planning process and receive LGA certification to establish their governance credentials implementation ultimately would put pressure on central government finances. Chapters needed a way to pay for the governance tasks and community improvements for which they were now responsible.

In 1999, in response to these predicted pressures on Navajo Nation government revenues, the Office of the Navajo Tax Commission (ONTC) began drafting legislation to establish a sales tax on goods and services sold within the reservation's boundaries. Next, it held public hearings within each of the Nation's five agencies to gain public feedback on issues such as the rate at which transactions might be taxed and the uses to which tax revenues should be put. This feedback was included in the final version of the sales tax bill, which was approved by the Navajo Nation Council in October 2001 and became effective on April 1, 2002.

Today, the Navajo Nation levies a three percent tax on gross receipts from the sale of goods and services on the reservation. The law includes all transactions in Navajo Nation territory, even if a business's primary address is off-reservation. For example, a general contractor located in Gallup, New Mexico who performs work at Navajo is required to report the value of goods or services sold on the reservation to the ONTC and pay tax on that total. Each business must file reports and submit sales taxes quarterly (paperwork and payments are due May 15, August 15, November 15, and February 15). Critically, there are exceptions to the tax, many of which were determined with citizen input; these include sales related to Native American ceremonies, medical care and prescriptions, child care, automobiles for personal use, itinerant and occasional sales, and/or sales by a non-profit or educational institution.

The sales tax code also earmarks portions of total collections for particular uses. Twelve percent of gross revenue is deposited in the Nation's Permanent Trust Fund (an endowment used to promote the quality of life enjoyed on the Navajo Nation by its members), two percent is deposited in the Land Acquisition Fund, and at least one percent is deposited in the Tax Administration Suspense Fund (for taxpayer refunds). Remaining monies constitute net tax revenues and are distributed to the central tribal government and chapter governments according to business addresses. Net sales tax receipts from off-reservation business are paid into the Navajo Nation's General Fund and used for central government operations. A chapter certified under the LGA receives 100 percent of the net sales tax revenue generated by businesses in that chapter. If a chapter is not certified under the LGA, net sales tax revenues generated by businesses in that chapter are distributed at the agency level; fifty percent of this revenue is divided equally among the chapters in the agency and the other 50% is distributed in proportion to the chapters' registered voters. The system not only directs more money to chapters that are taking greater responsibility for local government but also creates an incentive for LGA certification.

Since enacting the sales tax, the ONTC has collected nearly $44 million, with chapters receiving approximately $12 million of that total. These figures show that the sales tax is meeting both goals the Navajo Nation set for this new income stream to compensate for central government revenue losses from the slowdown in mining operations and to support the chapters as they take on new governing responsibilities. Critically, the distribution to chapters from sales tax receipts does not replace other funding; these are entirely new and additional resources for Navajo local governments. ONTC staff also project that sales tax revenue will continue to increase, further decreasing the Nation's dependence on income from non-renewable resources and further increasing local government revenues.

The Navajo Nation's implementation of a sales tax has been successful for a variety of reasons. First, the Nation had already established a taxation infrastructure. The Office of the Navajo Tax Commission was created in 1974 as the agency responsible for implementing the Navajo Nation's then-new laws taxing business activity and possessory interests (oil and gas leases, coal leases, rights-of-way, and business site leases, etc.). Its work and development began in earnest in 1985, after the U.S. Supreme Court reaffirmed the Navajo Nation's right to impose taxes. Over the next several years, the Nation also enacted an oil and gas severance tax (1985), a hotel occupancy tax (1992), a tax on tobacco products (1995), and in the same year as the sales tax (1999), a fuel excise tax. While the ONTC is part of the central government, its single mission allows it to concentrate on the appropriate administration of tax law and to develop credibility with taxpayers.

Second, the ONTC paid careful attention to the proposal process and language of the law, which made the idea of a sales tax more acceptable and the implementation process smoother. For example, by holding hearings that addressed the policy overall, possible tax rates and uses to which revenues might be put, the ONTC built taxpayer-level support from the outset. It backed up this outreach by writing the proposed code changes in easy-tounderstand language. And, knowing that taxpayers are more likely to comply if they are familiar with the process, it suggested sales tax policy that was similar to the policies of the states in the region. Additionally, the office took time to determine a viable tax rate. Too high of a rate (especially one that was too high relative to the rates charged by surrounding jurisdictions) would have discouraged businesses from locating on the reservation and discouraged customers from shopping at businesses that did. By keeping an eye on the how these incentives have played out, the ONTC now thinks it may even be possible to make a slight increase in the Navajo Nation sales tax.

Third, the distribution of substantial sales tax revenue to the chapters generates support for the policy and may even increase compliance. Chapter governments like the policy not only because it raises revenue for them, but because it does so in an efficient way. Chapter representatives no longer have to approach their Council members, lobby them, and then wait while the Tribal Council approves an expenditure or budget change. With the sales tax revenue distribution, chapter governments can be more responsiveness to the needs of their citizens; not surprisingly, chapters have used the revenues for road repairs, power and telephone line extensions, public building construction and renovations, upgrades to elders' homes, and so on. Even chapters that receive relatively small allocations can save toward more ambitious undertakings. In addition, tribal citizens who spend their money on the Navajo reservation are able to see their tax dollars working across the region and in their own backyards.

Governments around the world use tax revenue to provide services to their citizens and to support general government functions. From sidewalks and street lights, to police officers and court systems, taxes make it possible for governments to accomplish the tasks they are assigned by their citizens. Among Native nations, the Navajo Nation has been a leader in the generation of own revenues through taxation. By implementing a sales tax, the tribe has lessened the impact of decreased revenue from natural resource extraction, increased the central government's financial stability, and provided local governments with significant new revenue. This exercise in self-determination strengthens the nation's ability to serve its citizens.

Lessons:

- Revenue generated from taxes can decrease government dependency on other, less sustainable sources such as non-renewable resources and federal grants.

- By exercising their right to tax, tribal governments can help sustain critical government functions; build infrastructure; and provide necessary public services like road maintenance, waste management, child care, education, health care, and law enforcement, to name a few.

- Formulas for revenue-sharing between communities within a Native nation can mitigate the impact of uneven development, while also providing smaller areas with limited tax bases more financial resources to both serve their citizens and seed growth.