

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

October 24, 2006

Third Party Communication: None  
Date of Communication: Not Applicable

Number: **200705027**  
Release Date: 2/2/2007  
Index (UIL) No.: 7871.03-00  
CASE-MIS No.: TAM-146705-05

Director  
Office of Tax Exempt Bonds

Taxpayer's Name:  
Taxpayer's Address:

Taxpayer's Identification No  
Year(s) Involved:  
Date of Conference:

LEGEND:

Issuer =  
Bonds =

Date =  
Tribe =  
Loan Agreement =

X =

City A =

City B =

ISSUE:

- 1) Under § 7871(a)(4) and § 7871(c) of the Internal Revenue Code, may the Tribe be properly treated as a governmental unit for purposes of § 103(a) regardless of whether the proceeds of the Bonds are to be used in the exercise of an essential governmental function within the meaning of § 7871(e)?
- 2) Whether the Service should grant the Issuer's request to limit the retroactive application of any adverse decision in this case pursuant to § 7805(b)

CONCLUSIONS:

- 1) Under § 7871(a)(4) and § 7871(c), the Tribe may be treated as a governmental unit, for purposes of § 103(a) only if the proceeds of the Bonds are to be used in the exercise of an essential governmental function within the meaning of § 7871(e).
- 2) The Issuer's request for relief under § 7805(b) is denied. The holdings of the technical advice memorandum in this case will be applied retroactively.

FACTS:

The Tribe is listed as an Indian tribal government in Rev. Proc. 2002-64, 2002-2 C.B. 717. On Date, the Issuer issued the Bonds and, pursuant to the Loan Agreement, loaned the proceeds to the Tribe. The Loan Agreement sets forth the Tribe's responsibilities with respect to its loan from the Issuer including the obligation to repay the loan. The Tribe used the Bond proceeds to finance and refinance the planning, design, development, construction, installation, equipping and opening of: (1) a convention facility with an approximately x-room full-service four-diamond quality conference hotel and ancillary facilities on the Tribe's reservation located near City A and (2) a convention facility with an approximately x-room full-service four-diamond quality conference hotel and ancillary facilities on the Tribe's reservation located near City B, (together, the "Project").

## LAW AND ANALYSIS:

## ISSUE 1

Section 103(a) provides that except as provided in § 103(b) gross income does not include interest on any state or local bond. Section 103(c) provides that a state or local bond is an obligation of a state or political subdivision thereof.

Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(a)(1) provides that a private activity bond is any bond issued as part of an issue that meets (i) the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2) or (ii) the private loan financing test of § 141(c).

Private business use is defined by § 141(b)(6)(A) as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Under § 141(b)(6)(B), any activity carried on by a person other than a natural person shall be treated as a trade or business. Indian tribal governments are “persons” under the definition of § 7701(a)(1). See Chickasaw Nation v. U.S., 208 F. 3d 871, 879 (10th Cir. 2000). Because a tribe is an entity, it is not a natural person for purposes of § 141.

Section 1.141-1(b) defines a nongovernmental person as a person other than a governmental person. Section 1.141-1(b) defines a governmental person as a state or local governmental unit as defined in § 1.103-1. Under § 1.103-1(a), a state or local governmental unit means a state, territory, a possession of the United States, or any political subdivision thereof. Thus, for purposes of the private business use test of § 141, an entity is determined to be a governmental unit if it is a state or political subdivision under § 103.

The term Indian tribal government is defined under § 7701(a)(40) to mean the governing body of any tribe, band, community, village or group of Indians, or (if applicable) Alaska Natives that is determined by the Secretary of Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions. The Secretary’s determination is set forth in Rev. Proc. 2002-64, which contains a modified and supplemented list of Indian tribal governments that are to be treated similarly to states for specified purposes under the Code.

Section 7871 sets forth the various purposes for which an Indian tribal government may be treated as a state. Section 7871(a)(4) provides that subject to § 7871(c), an Indian tribal government shall be treated as a state for purposes of § 103 (relating to state and local bonds).

Section 7871(c)(1) provides that § 103(a) shall apply to an obligation (not described in § 7871(c)(2)) issued by an Indian tribal government (or a subdivision

thereof) only if the obligation is part of an issue substantially all of the proceeds of which are to be used for the exercise of any essential governmental function within the meaning of § 7871(e).

Section 1.150-1(b) defines an obligation for purposes of § 103 as any valid evidence of indebtedness under general Federal income tax principles.

The Loan Agreement is an obligation under § 1.150-1(b). Accordingly, the terms “issued” and “obligation” as used in § 7871(c) apply to the Loan Agreement as well as to the Bonds.

Whether the Tribe is to be treated as a state with respect to its use of the Bond proceeds depends upon the application of §§ 7871(a)(4) and (c) to the instant transaction. Two possible interpretations of this statute have been presented. The agent interprets the statute to mean that an Indian tribal government can be treated as a state for purposes of § 103 only if the requirements of § 7871(c) are met. The Issuer interprets the words “for purposes of section 103 (relating to State or local bonds)” in § 7871(a)(4) to require the general treatment of an Indian tribal government as a state for all tax-exempt bond purposes, including the private activity bond tests of § 141. The Issuer reads the requirements of § 7871(c) as applying only where the Indian tribal government issues the obligation and in such cases § 7871(c) only affects whether interest on the obligation is tax-exempt under § 103(a). Accordingly, the Issuer argues that the Tribe, as a conduit borrower of the Bond proceeds, is a governmental unit for purposes of the private business use test of § 141(b) regardless of whether the Bond proceeds are used for an essential governmental function.

The existence of competing interpretations of the specific language in § 7871(a)(4) conflicts with the Issuer’s assertion that its interpretation captures the “plain meaning” of the statute. However, even if the Issuer’s interpretation were assumed to follow the plain meaning of the words, the result of applying that interpretation would run counter to Congressional intent. Where the language of a provision, standing alone, produces results plainly at variance with the purpose of the legislation as a whole, the purpose rather than the literal wording of the provision should be followed. In United States v. American Trucking Associations, Inc., 310 U.S. 534, 543-544 (1940), the Supreme Court stated:

When [a statute’s plain] meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one ‘plainly at variance with the policy of the legislation as a whole’ this Court has followed that purpose rather than the literal words. When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no ‘rule of law’ which forbids its

use, however clear the words may appear on ‘superficial examination.’ (citations omitted).

The essential governmental function limitation has been in place since the original enactment of § 7871 as a temporary provision of the Code in 1982. The Report of the Senate Finance Committee, which added the essential governmental function requirement with respect to obligations issued by Indian tribal governments, explains:

The bill provides that Indian tribal governments are to be treated generally the same as States (and tribal subdivisions are to be treated generally the same as political subdivisions of States) for purposes of the tax-exempt bond interest provisions. However, the bill includes a number of restrictions on this treatment of Indian tribal governments with respect to commercial or industrial activities or other activities other than essential governmental functions. The purpose of those restrictions is generally either (1) to allow the profits from such activities to be exempt from Federal income tax (because of the basic Federal income tax exemption of Indians and because section 115 does not apply to Indians) or (2) to allow the interest on the obligations where the proceeds are used in such commercial or industrial activities to be exempt from Federal income tax, but not to allow both of these income tax benefits to apply in any one case.<sup>1</sup>

Congress remained concerned that the benefits of tax-exempt bond financing should not be used by Indian tribal governments for commercial or industrial activities and in 1987 limited Indian tribal governments to the tax-exempt financing of only essential governmental functions that are customarily performed by state and local governments. See P.L. 100-203 (December 22, 1987) § 10632. During the same period between 1982 and 1987, Congressional actions limiting the ability of states and local governments to enter into conduit financings with the proceeds of tax-exempt bonds, including limitations on the type of property financed and the amount that could be financed on an annual basis, indicate a concern that states and local governments were not sufficiently monitoring the private use of tax-exempt bond proceeds.

In keeping with the Congressional intent that Indian tribal governments, including the Tribe, benefit from tax-exempt financing only when essential governmental functions are financed, we concur with the agent’s interpretation and find the phrase “subject to subsection (c), for purposes of section 103 (relating to State and local bonds)” in § 7871(a)(4) to mean that § 7871(a)(4) is subordinate to or governed by<sup>2</sup> § 7871(c) with respect to obligations issued by an Indian tribal government. Thus, the two sections, read together, limit the applicability of § 7871(a)(4) to an Indian tribal government only if

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<sup>1</sup> S. Rep. No. 97-646, 2d sess. at 13-14 (1982).

<sup>2</sup> See Black’s Law Dictionary, 6<sup>th</sup> ed. (1990) definition of the phrase “subject to”.

the Indian tribal government issues an obligation and the proceeds of the obligation are used for an essential governmental function<sup>3</sup>. Accordingly, we conclude that the Tribe may be treated as a governmental unit for purposes of § 103 and § 141 only if the proceeds of the Loan Agreement are to be used for an essential governmental function. The question of whether the Bond proceeds are to be used by the Tribe in the exercise of an essential governmental function is addressed in a separate Technical Advice Memorandum.

We note that our conclusion does not rest on the position that the Tribe is the real obligor on the Bonds for purposes of § 103. In Fairfax County Economic Development Authority v. Commissioner, 77 T.C. 546 (1981) the Tax Court held that the nature of the “real obligor” for an issue of bonds is immaterial in determining whether the bonds are issued by a state or local government. Consistent with Fairfax County, we do not conclude that the Bonds were issued by the Tribe. Fairfax County, also, does not apply to the determination of whether the Loan Agreement, an obligation for purposes of § 103, was issued by the Tribe in its capacity as a state.

## ISSUE 2

The Issuer requests that any adverse decisions reached in this technical advice memorandum be applied without retroactive effect pursuant to § 7805(b). Section 7805(b) provides that “[t]he Secretary may prescribe the extent, if any, to which any ruling (including any judicial decisions or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.”

Section 15.02 of Rev. Proc. 2006-2, provides that the holding of a technical advice memorandum is ordinarily applied retroactively. Relief under § 7805(b) is usually granted only if a taxpayer relied to its detriment on a published position of the Service or on a letter ruling or technical advice memorandum issued to that taxpayer. In

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<sup>3</sup> This comports with the approach taken by the § 305.7871-1(c) of the Temporary regulations issued under § 7871 which provides that:

An Indian tribal government shall be treated as a State and a subdivision of an Indian tribal government shall be treated as a political subdivision of a State for purposes of any obligation issued by such government or subdivision under section 103 (relating to interest on certain governmental obligations) if such obligations are part of an issue substantially all of the proceeds of which are to be used in the exercise of an essential governmental function . . . .

Section 305.7871-1 of the Temporary regulations was issued in 1984 prior to Congress making § 7871 a permanent provision of the Internal Revenue Code and accordingly § 305.7871-1(f)(2)(i) provides that the tax exempt bond provisions of § 305.7871-1 apply to obligations issued before January 1, 1985. It is interesting to note that both the House Report and the Conference Report with respect to the Omnibus Budget Reconciliation Act of 1987, P.L. 100-203 (December 22, 1987), make reference to the Temporary Regulations and specifically overrule certain provisions contained therein.

the present case, the Issuer did not request a private letter ruling nor were any technical advice memoranda issued in connection with this or any similar earlier case involving the same taxpayer. Moreover, there are no regulations, revenue rulings or other published guidance on which the Issuer could have relied for its interpretation of § 7871. Although the Issuer presents a reasoned argument for its interpretation of § 7871, that interpretation, as demonstrated above, is not the only interpretation and indeed is not the interpretation the government ultimately thinks is the best reading of the law. Section 7805(b) relief is not warranted solely because a taxpayer claims it could not foresee the Service's resolution of a difficult tax law question. Accordingly, the Issuer's request for relief under § 7805(b) is denied.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.