

Office of Chief Counsel
Internal Revenue Service
Memorandum

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CC:ITA:B01:GJTurner
POSTU-113265-08

Third Party Communication: None
Date of Communication: Not applicable

UILC: 162.00-00

date: August 03, 2009

to: Julie Payne
Associate Area Counsel (Seattle Group 1)
(Small Business/Self Employed)

from: John P. Moriarty
Chief, Branch 1
(Income Tax & Accounting)

subject: POSTU-113265-08

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

You requested assistance in determining whether the taxpayer may deduct under § 162 of the Internal Revenue Code, the value of property conveyed to the State of Alaska and City and whether the Taxpayer's replacement cost valuation of land and personal property is permissible. This confirms the telephone conversations of Date 2 and Date 3, in which we advised that the Taxpayer may deduct under § 162 the value of property conveyed to the State of Alaska and City and that the Taxpayer's replacement cost valuation of land and personal property is permissible.

Please contact Gwen Turner at 202-622-5020 if you have any questions about our conclusion or reasoning.

LEGEND

Taxpayer =
City =
Territory =
Island =
A =
B =

\$c =
\$d =
Year 1 =
Year 2 =
Year 3 =
Date 1 =
Date 2 =
Date 3 =
Item 1 =
Item 2 =

ISSUES

- 1) May Taxpayer deduct under § 162 the value of property conveyed to the State of Alaska and City?
- 2) Is Taxpayer's replacement cost valuation of land and personal property permissible?

CONCLUSIONS

- 1) Taxpayer may deduct the value of property conveyed to the State of Alaska and City under § 162.
- 2) Taxpayer's replacement cost valuation of land and personal property is permissible.

FACTS

Taxpayer is an Alaska Native Regional Corporation formed under the Alaska Native Claims Settlement Act (ANCSA), Pub. L. 92-203, 85 Stat. 713 (December 18, 1971) (ANCSA), as amended by the Alaska National Interest Lands Conservation Act, Pub.L. 96-487, 94 Stat. 2371 (December 2, 1980) (ANILCA). The purpose of ANCSA was to settle and extinguish Alaska Natives' aboriginal land claims by conveying to Alaska Natives, over a number of years, the right to select and to receive fee title from the United States to some 44 million acres of public federal land in Alaska and to receive payment from the United States of \$962.5 million. ANCSA established various Native Corporations for purposes of distribution of land and money in settlement of claims against the United States. These Corporations were divided by geographical region into Regional, Village and Municipal Corporations. Each Native Corporation was granted the right to select and receive conveyance to a specified portion of the 44 million acre land settlement.

Taxpayer's territory primarily covers the Territory. Island, which is part of the Territory, was not available for selection under ANCSA because it was part of a National Wildlife Refuge and because a portion was withdrawn for use by the United States Navy prior to the passage of ANCSA. Taxpayer sought to acquire land on Island in exchange for

unused land selection rights received under ANCSA. After many years of negotiation with the Department of Interior and the Department of the Navy, an agreement was signed in Year 1 (the Agreement). In Year 2, City was incorporated as a second-class city by the State of Alaska.

On Date 1, the Island transfer was completed. Pursuant to the Agreement, Taxpayer reconveyed certain Island properties to the State of Alaska and City. The State of Alaska received Item 1. City primarily received Item 2 within the city boundaries. Because the reconveyances were required by the Agreement, Taxpayer treated them as meeting the requirements of Section 14(c) of ANCSA.

Subsequent to the reconveyances, Taxpayer obtained an appraisal of the Item 1 and an appraisal of the land reconveyed to both government entities and the improvements reconveyed to City. Taxpayer claimed deductions on its Year 3 tax return of \$c for the transfers to the State of Alaska and \$d for the transfers to City based on these appraisals.

Section 14 of ANCSA (as amended by ANILCA) imposes certain requirements on Native Corporations with respect to their lands. Section 14(c)(3) requires Village Corporations reconvey without consideration, land to the individual and business occupants located within their respected villages. Title to any remaining land in the villages is to be reconveyed to any municipal corporation located therein. Section 14(c)(4) requires Village Corporations to convey to Federal, State or local governments of title to the surface estate for airport sites, together with any additional acreage or easements necessary to provide government services.

Section 21 of ANCSA (as amended by ANILCA) provides special tax provisions to ensure that the receipt of certain revenues, stock, and land by the Native Corporations were tax-free. Section 21(c) of ANCSA provides that the receipt of land or any interest therein pursuant to this Act or of cash in order to equalize the values of properties exchanged pursuant to subsection 22(f) shall not be subject to any form of Federal, State, or local taxation. The basis for computing gain or loss on subsequent sale or other disposition of such land or interest in land for purposes of any Federal, State, or local tax imposed on or measured by income is the fair value of such land or interest in land at the time of receipt.

Section 21(h) of ANCSA (as added by Public Law 95-178 on November 15, 1977) also provides special tax provisions regarding the selection and conveyance of land to the Native Corporations. Section 21(h) provides:

(1) Notwithstanding any other provision of law, each Native Corporation established pursuant to this Act shall be deemed to have become engaged in carrying on a trade or business as of the date it was incorporated for purposes of any form of Federal, State, or local taxation.

(2) All expenses heretofore or hereafter paid or incurred by a Native Corporation established pursuant to this Act in connection with the selection or conveyance of lands pursuant to this Act, or in assisting another Native Corporation within or for the same region in the selection or conveyance of lands under this Act, shall be deemed to be or to have been ordinary and necessary expenses of such Corporation, paid or incurred in carrying on a trade or business for purposes of any form of Federal, State, or local taxation.

LAW AND ANALYSIS

Issue 1:

Taxpayer deducted the fair market value of property it conveyed to the State of Alaska and City under § 162 and Section 21(h) of ANCSA. Taxpayer claimed that the reconveyances were in satisfaction of its obligations under Section 14(c) of ANCSA.

Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 21(h) of ANCSA provides that all expenses paid or incurred by a Native Corporation established pursuant to ANCSA in connection with the selection or conveyance of lands pursuant to ANCSA are deemed to be or to have been ordinary and necessary expenses of the corporation, paid or incurred in carrying on a trade or business for purposes of any form of Federal, State, or local taxation. Congress amended ANCSA to add Section 21(h), because it was concerned with the Service requiring capitalization of land selection and conveyance costs and intended that the amendment allow a deduction for those costs. The amendment provides that Native Corporations (1) do not include in income the value of outside surveys; (2) may deduct land selection costs; (3) are deemed to have begun business; and 4) are not personal holding companies. H.R. Conf. Rep. No. 95-1800, 95th Cong., 2d Sess. 282 (1978).

ANCSA does not define “in connection with the selection or conveyance of lands pursuant to ANCSA.” The Service previously read this provision of ANCSA narrowly. In Old Harbor Native Corporation v. Commissioner, T.C. 191 (1995), one issue was whether the Taxpayer, an Alaska native village corporation organized under ANCSA, could deduct as an ordinary and necessary business expense an amount paid to lobby the Congress to pass legislation allowing it to exchange certain lands with the United

States Government under ANCSA. The land exchange at issue was governed by Section 22(f) of ANCSA, which provides in part that the Secretary of Interior is authorized to exchange lands or interests therein, including Native selection rights, with Native Corporations for the purpose of effecting land consolidations or to facilitate the management or development of the land, or for other public purposes.

In Old Harbor the Service argued that Section 21(h)(2) of ANCSA was intended to apply only to the Native Corporations' initial selection and conveyance of lands under ANCSA, and not to subsequent land exchanges under ANCSA. The court held otherwise, stating that the provisions of ANCSA should be read broadly and in the light most favorable to Alaskan natives, the intended beneficiaries of ANCSA. The Court also viewed ANCSA as a whole, rather than viewing and reading each section of ANCSA separately and in isolation. Applying this rationale to the facts at issue, the court concluded that the lobbying expenses were incurred in connection with a conveyance of land within the meaning of Section 21(h)(2) of ANCSA. As a result, the expenses were deductible under that section.

Section 14(c)(3) of ANCSA requires Village Corporations to reconvey title to occupied land within its jurisdiction to Native residents, business owners and to convey to the municipality the "improved land on which the Native village is located" and additional land as necessary for "community expansion" and "appropriate rights-of-way for public use" and "other foreseeable community needs."

Section 14(c)(4) of ANCSA requires Village Corporations to reconvey title to the surface estate for airport sites, airway beacons, together with additional acreage and easements as are necessary to provide related governmental services to the Federal Government, State of Alaska, or to the appropriate municipal government.

In this case, Taxpayer is a Regional Corporation and the reconveyances were required by the Agreement. Because there were no Village Corporations on Island, it is apparent that the provisions of the Agreement requiring the reconveyances were intended to mirror the requirements of Section 14(c) of ANCSA.

Under the rationale of the court in Old Harbor Native Corp., Taxpayer's conveyances to the State of Alaska and City are in connection with the selection or conveyance of lands pursuant to ANCSA. Therefore, the fair market value of the lands conveyed by Taxpayer is deductible under § 162 for federal income tax purposes.

By enacting ANCSA, Congress expressed its intent that in exchange for the surrender of land claims by Alaska Natives, the U.S. would transfer land to Alaska Natives under ANSCA tax-free. Furthermore, under this provision lands were conveyed to Alaska Natives with the highest possible tax basis or a "fresh start basis," to prevent income tax liability from arising if the lands were later converted into cash or other property.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call if you have any further questions.