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**TRIBAL BUSINESS STRUCTURES
FORMATION AND FINANCING**

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PRESENTER

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- With Acknowledgment for the many contributions of my Co-Author (Tribal Business Structure Handbook—forthcoming from DOI's Division of Indian Energy and Economic Development), Karen Atkinson, President of Tribal Strategies and Executive Director of Native American Contractors Association

OVERVIEW

- Key Factors in Choosing a Structure
- Governmental Entities Used for Business
- Corporations, LLCs and Joint Ventures
- Case Studies -- Focus on Financing Considerations

KEY FACTORS IN ENTITY STRUCTURE

- Facilitating Best Business Practices, including
 - Insulating “business” from politics
 - “Corporate” – style governance
- Maintaining Sovereign Immunity and Limiting Legal Liabilities

KEY FACTORS IN ENTITY STRUCTURE (continued)

- Ease of Formation, including timeline for regulatory approvals
- Tax Treatment – income, sales, and excise taxes
- Qualification for Financing of Various Types
 - tax-exempt financing
 - government-subsidized loans

GOVERNMENTAL ENTITIES

- Tribal Government
- Political Subdivision of Tribal Government
- Unincorporated Instrumentality

BASIC BUSINESS ENTITIES

- Corporation
- Partnership
- Limited Liability Company (LLC)

TAXATION OF TRIBES (Rev. Rul. 94-16)

- IRS has consistently ruled that the Tribe is not a taxable entity.
- Income derived from any business operated directly by a Tribe will be tax free.
- No reservation-boundary limitation.

TAXATION OF TRIBAL GOVERNMENT

- Federally recognized tribal governments also have some of the same tax benefits as states.
 - Income tax deductibility for charitable contributions.
 - Estate and gift tax deductibility for gifts and bequests.

TAXATION OF TRIBAL GOVERNMENT (continued)

- Tax-exempt bond financing authority (limited to essential government functions).
- Exemption from various excise taxes (also subject to the essential government function test).
- Treatment as government under private foundation tax rules.

POLITICAL SUBDIVISIONS

- Political subdivision has the same tax-free status as the Tribe.
- Political subdivision shares in other tax benefits under IRC §7871
 - Tax-exempt bond authority
 - Excise tax exemptions

POLITICAL SUBDIVISIONS (continued)

- Tribal political subdivision must exercise one or more sovereign power(s)
 - Power to tax
 - Power of eminent domain
 - Power to regulate
- 2-Part determination to confirm status:
 - Department of Interior
 - Internal Revenue Service

ADVANTAGES OF POLITICAL SUBDIVISION

- Relative certainty of federal tax treatment
- Likely retention of state tax immunity
- Retention of sovereign immunity
- Ability to form a board
- Potential use as a regulatory body and holding company

DISADVANTAGES OF A POLITICAL SUBDIVISION

- Time and expense associated with the formation of the entity
- Political subdivisions do not have the flexibility of a business entity
- Certain business partners may not be comfortable dealing with any type of governmental entity

UNINCORPORATED INSTRUMENTALITY

- Tribe may operate a business tax-free through an unincorporated division or an instrumentality.
- Advantage: Relative certainty of tax treatment
- Disadvantages:
 - Governance issues
 - Requirements of partners and lenders
 - Mixing business and politics

UNINCORPORATED INSTRUMENTALITY (continued)

- Must meet “instrumentality” test to ensure tax treatment
- Instrumentality Factors include:
 - whether the entity is used for a governmental purpose and performs a governmental function;
 - whether performance of its function is on behalf of one or more tribes or political subdivisions;

UNINCORPORATED INSTRUMENTALITY (continued)

- whether there are any private interests involved, or whether the tribe has the power and interests of an owner;
- whether control and supervision of the organization is vested in a tribal authority or authorities;

UNINCORPORATED INSTRUMENTALITY (continued)

- whether express or implied statutory or other authority is necessary for the creation and/or use of the organization, and whether this authority exists; and
- the degree of financial autonomy of the entity and the source of its operating expenses.

TRIBAL BUSINESS CORPORATIONS

- Federal Law Corporations
- State Law Corporations
- Tribal Law Corporations

FEDERAL LAW CORPORATIONS

- Advantages: Certainty of Tax Status
 - Section 17 of Indian Reorganization Act
 - Rev. Rul 94-16
- Disadvantages
 - BIA approval and ratification process can be cumbersome/time-consuming.
 - Act of Congress to dissolve entity

FEDERAL LAW CORPORATIONS (continued)

Section 17 Procedures:

- Draft Charter;
- Pass Tribal Resolution (petitioning DOI to Issue Charter);
- Obtain Tribal Approval of the Charter;
- Present Resolution and Charter to BIA for Approval; and
- Ratify the BIA-approved Corporate Charter

FEDERAL LAW CORPORATIONS (continued)

- Financing Considerations
 - One PLR suggests that a Tribe's Section 17 can issue bonds
 - Not sure IRS would still issue similar ruling

STATE LAW CORPORATIONS

- Taxable if incorporated under state law.
 - Rev. Rul. 94-16 -- state-law corporation with Tribe as sole shareholder not tax-free.
 - PLR 9826005 -- wholly-owned state-law health corporation not an integral part of Tribe and therefore cannot issue tax-exempt bonds.
- IRS may be re-examining this conclusion.

TRIBAL LAW CORPORATIONS

- Since 1994, income tax status has been uncertain
 - Rev. Rul 94-16 did not address
 - In 1996, classification of entity regulations did not address, but preamble noted that Treasury and IRS were still studying issue.
- In 2001, Treasury/IRS agreed to resolve the uncertainty.
 - Progress on new ruling has been slow

TRIBAL LAW CORPORATIONS (continued)

- Two possible approaches
 - Treat like Section 17 corporations (per se approach).
 - Apply Integral Part test (facts and circumstances approach).
- IRS has stopped issuing “integral part” rulings to both tribal government-owned and state government owned corporations

TRIBAL LAW CORPORATIONS (continued)

- Integral Part Test focuses on:
 - Governance control
 - Financial accountability
- New IRS Guidance Plan says IRS will be issuing regulations “providing criteria for treating an entity as an integral part of a state, local or tribal government”

ANOTHER OPTION: LIMITED LIABILITY COMPANY (LLC)

- An increasing popular choice of business entity is the LLC.
 - LLC has limited liability like corporation.
- Tax Treatment
 - If owned by two or more members, it is taxed like partnership.
 - If wholly-owned, a single-member LLC may be “disregarded” as separate entity.

SINGLE-MEMBER (“SM”) LLCs

- State and local gov’t SM LLCs are treated like corporations under IRS regulations
- So far, IRS has not extended this rule to tribal SM LLCs
- But IRS has extended the per se corporation rule to foreign gov’t SM LLCs
- Will new “integral part” rules apply to government-owned LLCs?

LLCs AND FINANCING

- Underwriters do not favor the issuance of bonds by LLCs
- Government guaranteed loans, commercial bank financing and other options would be available

JOINT VENTURES

- Choice of entity
 - Corporation (generally not tax-efficient)
 - Partnership (flow-through tax treatment)
 - LLC (same as partnership)
- Choice of law
 - State
 - Tribal

JOINT VENTURES (continued)

- If a Tribe is a member of a partnership (or an LLC treated as partnership) it will not be taxed on its share of JV's gross income
- Tribe and JV partner can structure how profits and losses, deductions and tax credits are allocated – within limits
 - Substantial economic effect
 - Tax-exempt entity leasing rules

CASE STUDY #1: ECONOMIC DEVELOPMENT AUTHORITY (PLR 20063502)

- Tribe created Authority under Tribal Law for economic development
- Tribe delegated economic development powers to Authority:
 - Development, construction, operation, promotion, financing, regulation, and licensing of new and existing Tribal businesses

CASE STUDY #1: ECONOMIC DEVELOPMENT AUTHORITY (PLR 20063502) (continued)

- Further economic and social development of the Tribe and its members
- Impose and collect taxes
- IRS held that Authority was a political subdivision of Tribe
 - Treated same as Tribe for purposes of Section 7871 (e.g., tax-exempt financing)
 - Not required to file tax returns

CASE STUDY #2: TRIBAL HEALTH ENTITY (PLR 9826005)

- Tribal Health Corporation
- Non-profit corporation formed under State law to operate a health center
- Corporation qualified for 501(c)(3) status
- Tribe wanted Health Corporation to issue tax-exempt bonds

CASE STUDY #2: TRIBAL HEALTH ENTITY (PLR 9826005) (continued)

- IRS held that Corporation was not a political subdivision (no sovereign powers)
- Also held not an integral part of the Tribe (because incorporated under state law)
- Therefore, it could not issue tax-exempt bonds
- As a 501(c)(3), however, it could utilize bonds issued by state or local health authority

CASE STUDY #3: SECTION 17 CORPORATION FOR ENERGY VENTURE

- Tribe establishes a wholly owned Section 17 corporation to use as a holding company for various subsidiaries—at least one of which may be operated as a joint venture
- One of the affiliates could be an 8(a) company
- Another could be an energy company—organized as an LLC in order to be facilitate use as a joint venture by the tribe and another party.

CASE STUDY #4: LLC FOR ENERGY JOINT VENTURE

- Tribe (or its Section 17 corporation) forms an LLC in which the Tribe will have a 51% interest and Energy Co. (E-CO) will have 49%
- E-CO is a taxable company and will be able to fully utilize any depreciation deduction or special tax credit from the venture
- All depreciation is allocated to E-Co, but the deduction offsets E-CO's capital account, therefore it has substantial economic effect

WHERE DO WE GO FROM HERE?

- Questions and Answers
- Follow-up Contact Information

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