

# TRIBAL BUSINESS STRUCTURE HANDBOOK



**2008 Edition**

**By**

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**and**

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**A Tribal Self-Governance Project of the Tulalip Tribes**

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**Disclaimer:** Nothing in this Handbook should be construed or relied upon as legal advice. Instead, this Handbook is intended to serve as general guidance and an introduction to business structure from which better informed requests for legal advice and tax advice can be formulated.

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## Foreword by the Sponsor and Publisher

The Office of Indian Energy and Economic Development (IEED) was established in 2006. IEED is responsible for expanding reservation business opportunities and Indian employment with emphasis on the development of energy and mineral resources on Indian trust lands; providing oversight of initiatives designed to assist tribes in developing stronger reservation and/or tribal economies; developing policies and procedures for job placement and training under the Indian Employment Training and Related Services Demonstration Act of 1992 (P.L. 102-477), as amended; and providing credit under the Indian Financing Act of 1974. The office formulates policies and procedures to surmount barriers to reservation economic growth and assists tribes in developing economic infrastructure, augmenting business knowledge, increasing jobs, businesses, and capital investment, and developing energy and mineral resources. IEED helps tribes develop their energy and mineral resources on trust lands and manages special economic programs, grants, projects and initiatives to advance reservation economies. In addition, the office is responsible for implementing P.L. 102-477, as amended; the Indian Financing Act of 1974; and Title V of the Energy Policy Act of 2005. The office consists of the Division of Energy and Mineral Development, the Division of Economic Development, the Division of Workforce Development, the Division of Capital Investment, and the Division of Indian Energy Resource Agreements.

We undertook this project to further our mission of developing economic infrastructure and increasing business knowledge. We think tribal governments will find the Handbook filled with many specifics that will help them and their business managers pinpoint issues for analysis in the quest to select the best business structure.

For tribal governments starting to think about launching a business enterprise, the Handbook will become a primary reference. The authors have taken care to streamline the discussions about each of the business structures. This should enable tribal governments to make informed decisions about which structure to discuss with tribal legal counsel and the tribal accountant.

For tribal government officials who are unfamiliar with business structures, the Handbook can also impart an understanding of how various Indian business enterprises function by comparison. We hope that this will encourage tribal governments to consult with one another regarding the success tribal businesses have achieved because of (and not in spite of) their structures.

There will be a second edition of the Handbook in the next several years.

A handwritten signature in black ink that reads "R W Middleton". The signature is written in a cursive, flowing style.

Robert W. Middleton, Ph.D.  
Director, Office of Indian Energy and Economic Development

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## I.

### INTRODUCTION

The late 20<sup>th</sup> century brought a new era of federal-tribal relationships and a policy of self-determination to Indian country. Indian Tribes are increasingly asserting control over their land, resources, and governance of their communities. Tribes are involved in a wide range of economic activities from tourism, gaming, energy, agriculture, forestry, manufacturing, federal contracting, and telecommunications. In many parts of the country, Tribes are becoming regional economic and political power houses. They are the largest employer in many counties. Tribal governments and tribal businesses engage in a wide range of business and financial transactions.

The unique legal status of tribes is only now beginning to be used by Tribal governments to contribute to their business and economic development efforts. This century marks a new era for tribes using their sovereign status and governmental authority to achieve economic self-sufficiency and cultural preservation. There are still high levels of poverty and unemployment in Indian country and a lack of the basic infrastructure crucial to the building blocks of economic success. There are, however, increasingly more examples of tribes breaking their dependence on federal programs and creating the necessary legal infrastructure to build the foundations for successful economic development.

As tribal business transactions become increasingly more sophisticated and involve non-Indian partners, investors, and lenders, there is a need to understand the basic methods for doing business in Indian country. In particular, in the energy industry, Indian tribes are shifting from being passive owners of their energy resources by evaluating ways in which they can own, develop, and produce their resources. Tribes are increasingly looking at ways to develop their resources in a manner that gives them an active ownership interest in the development of the project, often with a non-Indian business partner.

There are unique factors that a tribe should consider when deciding how to structure a business transaction or how to partner with a non-Indian business. This Handbook will provide a general guide to the key factors that an Indian tribe should consider when structuring a business or project. It will look at the basic structures available to tribal governments when organizing for economic development activities and will consider whether business formation should occur under tribal, federal or state law. It will also consider the tax consequences of each type of business structure. The Handbook will assist tribal managers in determining which structure will work best to protect tribal assets, preserve tribal sovereignty, and maximize the use of tax and other incentives available for tribal economic development. This guide is general in nature. You should consult legal counsel and accountants to determine the best business structure for your particular circumstances.

## **A. Why Choosing a Business Structure is Important**

The choice of business structure will have long-term and far-reaching consequences for a tribal government and tribal business. The business structure you choose will have a major impact on how tribal assets are protected, how tribal sovereignty is preserved, and how potential liability is minimized. Critical decisions regarding the tax status of the business entity and whether or how sovereign immunity is waived must be made early in the decision making process. The choice of business structure may also be determined by the requirements a lender imposes as a financing condition or be determined by a business partner seeking certainty and predictability in the legal framework chosen to organize for economic development. This Handbook will help you to compare and analyze different structures and help determine which is best for you.

## **B. Success Factors**

In the last decade, a substantial amount of research has been done to determine what impediments exist to creating long term sustainable economic development on Indian reservations and to identify the factors that have lead to significant progress on some reservations. Most tribes are committed to improving the economic welfare of its people and at the same time are concerned that this not be done in a way that diminishes their sovereignty. The Harvard Project on American Indian Economic Development (Harvard Project) has found that a key factor to achieve economic self-determination is to have institutions in place which promote self-governance and to provide a political environment in which investors will feel secure.<sup>1</sup>

Indian reservations have to compete with other venues to attract economic activities. To be successful, tribes must offer investors the opportunity to earn economic returns commensurate with the returns they might earn elsewhere. Investment dollars have to come from somewhere. Investor risk is raised if there is uncertainty in tax and regulatory policies that apply to on-reservation businesses or transactions. Risk is also raised if there is uncertainty regarding the enforcement of contracts or agreements. Governmental policies requiring preference hiring or policies that change frequently can also raise the risk and costs for investors or business partners.

The Harvard Project has identified a number of success factors geared to create a political environment that promotes sustained economic growth by providing a safe environment for investors. Such an environment helps investors--whether they be tribal members or outsiders--to feel secure and willing to put their time, energy and capital into the tribal economy. The first critical factor is for tribes to have a separation and allocation of governmental powers. This can be accomplished through formal or informal governmental structures.

The second critical factor is the separation of tribal electoral politics from the day-to-day management of business enterprises. This relates to the direct role that tribal governments often have in development projects. Tribal governments should have a role in strategic decision-making. However, tribal governments should not make the day-to-day business decisions of tribal enterprises. Maintaining this separation can be difficult for tribal officials since enterprises and its assets belong to all tribal members. However, not insulating tribal politics from tribal

businesses can create an uncertain and risky business environment for investors and business partners. Political instability, the possibility of opportunism on the part of tribal officials, and the difficulties in enforcing agreements can discourage investment. This can place tribes at a competitive disadvantage for attracting capital as well as technical and management expertise.

Inserting politics into day-to-day business decisions can drain the resources of the entity, and run a tribal enterprise into the ground. This type of governance will result in inefficiencies and loss of productivity that is difficult to absorb in a highly competitive environment.

Successful businesses in Indian country are typically insulated and their day-to-day business management is free from political interference. The Harvard Project found that tribally-owned enterprises that are insulated from political interference are about four times as likely to be profitable as those that are not.<sup>2</sup> The way tribes' have insulated business from politics has ranged from traditional culture-based separation of power to legal or tribal constitutional limits to the establishment of separate tribal entities and manage businesses. Insulating tribal business entities from political interference is accomplished by establishing a managing board of directors and a corporate charter that is beyond the direct control of tribal council members.

Businesses require a stable operating environment while managers need to make decisions in a business environment. The creation of a tribal business development corporation or other business entity separated from tribal government can provide a number of advantages:

- Free the tribal council from micro-managing tribal businesses and allow the council to focus on long-term development strategies and goals
- Assign responsibility to operate and manage tribal businesses to those who have business skill and knowledge
- Provide a buffer between managers and tribal politics
- Provide continuity and stability to business management by promoting the development of economic development and business policies that are less subject to change by electoral politics.<sup>3</sup>

This Handbook will describe a variety of options for tribes to consider when structuring tribal businesses in a way that segregates business from politics.

Key factors to consider when trying determining the best structure for a particular activity are:

**Segregate politics from business**--Free the tribal council from micro-managing tribal businesses while allowing the council to focus on long-term development strategies and goals. Assign responsibility to operate and manage tribal businesses to those who have business skill and knowledge.

**Organizational considerations**--How the entity is formed, under what law is the entity formed, and who manages the entity.

**Sovereign Immunity**--Tribes as governmental entities are not subject to suit unless they clearly waive immunity or Congress has waived their immunity. This raises questions regarding the ability of lenders, investors, and business partners to enforce agreements and to protect their investment. Each entity has different sovereign immunity implications that must be considered.

**Liability**--Some business structures effectively shield business owners from liability for the financial obligations and debts of the business. Others do not effectively separate owner obligations from business entity obligations.

**Tax considerations**--Different federal income tax rules apply to different business types. State tax liability frequently depends on whether the business activity is conducted on or off an Indian reservation.

**Financing**--Money for a business comes in two forms: (1) debt--whereby the business borrows and then owes money to others; and (2) equity--where investors provide funding and then own part of the business. Lenders generally do not dictate choice of business entity, but equity investors may specify what business structure you can choose.

### **C. Overview of Structures**

Tribal governments are distinct political entities in our federal system of government. They have the power of self-government and exercise sovereignty over their members and territory. Their sovereignty pre-dates the Constitution and is derived from the fact that they owned all the land that is now the United States. The U.S. Constitution acknowledges the sovereign status of Indian tribes in the Treaty Clause, in the 14<sup>th</sup> Amendment as "Indians not taxed," and in the Commerce Clause. The sovereign nature of Tribes has been recognized in the Constitution, treaties, court decisions, and the course of dealing with tribes. As sovereign Nations, Indian tribes have powers and capabilities not available to individuals. This Handbook will assist you in evaluating the different forms available for organizing economic development and to begin to take steps to achieve financial and economic independence.

When developing a new tribal enterprise, an important consideration is the applicable law and regulations governing its formation and operation. In Indian country, business entities can be formed under tribal law, state law or federal law. Your choice of law and the entity that is chosen will have consequences on issues relating to tax, financing, and sovereign immunity. It will also determine how you can maximize risks and liability. An important consideration for tribes is how to preserve tribal control and to protect tribal assets while providing a business partner or lender with certainty.

A tribe, because it is a sovereign nation, can form a governmental entity to perform business functions. This entity can be an instrumentality of tribal government, a political subdivision of the tribe, or an agency or division of the tribe. A tribe can also form a separate business entity formed under federal, tribal, or state law.

Below is a brief description of the main business structures.

## 1. Tribal Government

Many tribes conduct business through an economic development arm of the tribe. This is often referred to as in unincorporated instrumentality of the tribe. The business operation is generally overseen by the governing body of the tribe--sometimes by a business committee or a separate board, but they generally do not have a separate legal structure. Therefore, the same privileges and immunities of the tribe can apply to contractual agreements entered into by the tribe and to business instrumentalities of the tribe. Tribes and its business instrumentalities organized as an arm of the tribal government are not taxable entities for purposes of federal income tax.

## 2. Section 17 Corporations

Many tribes conduct their commercial activities through federally-chartered corporations formed under Section 17 of the Indian Reorganization Act (IRA).<sup>4</sup> To form a Section 17 Corporation, a tribe must petition the Secretary of the Interior for issuance of a corporate charter. A Section 17 corporation provides a framework by which a tribe can segregate tribal business assets and liabilities from the assets and liability of tribal governmental assets. It also preserves the integrity of the decision-making process of tribal governmental officials by separating business decisions. The charter defines the powers of the corporation which can include the power to buy and sell real and personal property and to conduct such further powers as may be incidental to the conduct of corporate business. Several courts have held that tribal sovereign immunity applies to the business activities conducted by a Section 17 Corporation; other courts have found a waiver of sovereign immunity in the "sue and be sued" clause of the corporate charter. Tribal corporations formed under Section 17 of the IRA have the same tax status as the tribe and are not subject to federal income taxes for income derived from on or off reservation activities.

## 3. Tribally Chartered Corporations

Some tribes have adopted tribal laws that govern the formation of tribally chartered for-profit corporations. These laws authorize the formation of tribal business entities owned by the tribe. Several courts have held that sovereign immunity applies to activities of a tribally chartered corporation owned by a tribe. The issue of whether tribally chartered corporations are subject to federal income taxes for income derived from on-reservation activities is up in the air. The Internal Revenue Service has this issue under consideration and has indicated that it will issue guidance, but has not yet done so.

## 4. State-law Corporation

A corporation is a legal entity that is formed under the laws of the state by filing a certificate of incorporation or articles of incorporation with the jurisdiction in which it is formed. Corporations are owned by shareholders and governed by a Board of Directors elected by the shareholders. Corporations are governed by the terms and conditions contained in its articles of incorporation. The main benefit of a corporation is that shareholders are not personally liable for the debts, obligations, or liabilities of the corporation. Shareholders are liable only for the

amount of their investment in the corporation. This insulates tribal government assets from the liabilities of a tribal corporation. However, a corporation is a separate taxpayer. Income is taxed twice, once at the entity level and again when distributed to shareholders as dividends. A corporation owned by a tribe, but chartered under state law is considered to have a different tax status than the tribe and is likely subject to federal income tax.

## 5. Limited Liability Company

The limited liability company (LLC) is a relatively new form of business entity that rose to prominence in the last ten years. Almost every state has enacted laws permitting the formation of an LLC. LLCs are formed by filing articles of organization with the state in which it is formed. It is a hybrid between a partnership and a corporation. It combines the primary advantage of a partnership--ease of formation and maintenance, and favorable taxation--with the key advantage of a corporation--limited liability protection for its owners. The owners of an LLC are typically called members. Individuals, corporate entities, tribes and tribal entities can be members of an LLC. Most states allow an LLC to have only one member. Like a partnership, its income is only taxed once. The tax attributes are passed down from the entity to its owners in proportion to their ownership interest--known as "pass through tax treatment." Therefore, a tribe's share of income from a LLC would not be subject to federal income tax.

### **D. Success Factors**

When choosing a business structure, there are many things a tribe should consider regarding business issues and tribal governmental issues. One of the key factors is how to preserve tribal control while also insulating business decisions from tribal governmental decisions or tribal politics. Another critical factor for tribes is how to preserve tribal assets and limit exposure to business liabilities. Other factors are: how to effectively manage the entity, how to maximize tax benefits, how to minimize financial risks, the location of business operations--on or off the reservation, what assets will be pledged, how the business will be capitalized, which structure enables the preferred method of equity or debt financing, and the requirements of one's business partner or lender.

This Handbook will look at key attributes to consider as you determine the ideal structure for your business. These include:

- Organizational considerations
- Sovereign immunity
- Legal Liability
- Federal tax treatment
- Financing considerations.

As you learn about each entity and evaluate these factors, you will be able to see how these factors all come together to create a business structure which best meets your needs. You

will see which businesses fit best with which entity type. You will have a working knowledge of the impact each of these factors will have on your business. When looked at together, these factors will point to the best entity choice for a particular tribal business enterprise.





## II.

### TRIBAL GOVERNMENT ENTITIES

#### A. Unincorporated Agencies, Divisions and Instrumentalities

##### 1. Description and Examples

Tribes are self-governing sovereigns with traditions of self-government that pre-date the Constitution. Accordingly, Tribal governments do not derive their powers or sovereignty from the United States. The sovereignty of tribes is recognized in the Commerce Clause and Treaty Clause of the U.S. Constitution. Tribes, generally exercise powers of self-government that are derived from their status as separate and distinct sovereigns.<sup>5</sup>

Tribes exercise inherent rights of self-government including the power to engage in business and commercial activities. Many tribes operate under traditional forms of government, or by adopting constitutions or codes under tribal law allowing them the power to engage in business and commercial activities.<sup>6</sup>

In addition, in 1934, Congress enacted the Indian Reorganization Act (IRA) to encourage economic and political self-determination by permitting tribes to organize their tribal governments under constitutions adopted pursuant to Section 16 of the IRA. Tribes had the option to accept or reject the IRA. Tribes that chose to organize their government under Section 16 of the IRA adopted a Tribal Constitution that was reviewed and approved by the Secretary of the Interior. Alaska and Oklahoma tribes were originally excluded from the IRA, but the provisions were later extended to Alaska Natives and similar provisions were extended to some Oklahoma tribes.<sup>7</sup>

Tribal constitutions adopted under Section 16 of the IRA typically established a system of centralized government with a chief executive, usually a Tribal Chairman or President, a legislature, usually a Tribal Council, a Tribal Business Committee, or Board of Directors that was vested with legislative and executive powers, and a weak judiciary.

Tribal governments often directly control or participate in business activities through unincorporated instrumentalities of the tribe. These are often referred to as an economic arms of the tribe. These instrumentalities or arms of tribal government are not considered to be distinct legal entities. Examples are tribal casinos, tribal enterprises, and tribal utilities.

##### 2. Organizational Characteristics

**Formation**--Unincorporated instrumentalities of a tribal government are formed under tribal law for commercial purposes and share the same legal characteristics of the tribal government because they are not separate legal entities. A tribe's constitution and

by-laws or codes may provide tribal governments with the power to create and operate subordinate economic entities. These entities are generally established by tribal resolution or by tribal ordinance.<sup>8</sup>

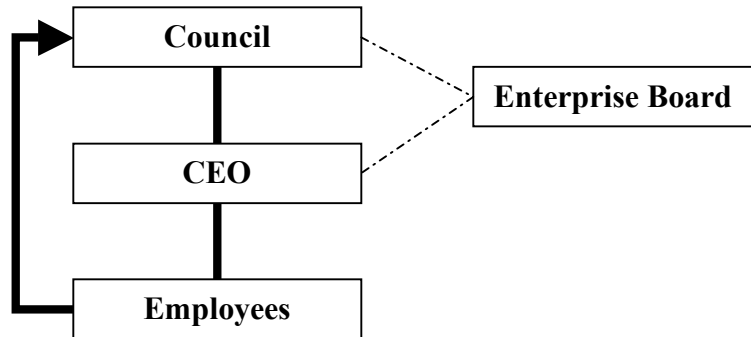
**Management**--These entities are usually directly controlled by the tribal government and its tribal council to serve as the development arm of the tribe. Sometimes a tribal enterprise may have a board of directors, but it is usually comprised of tribal council members. An unincorporated instrumentality often has a manager in charge of its day-to-day operations.

**General Characteristics**--Tribes have operated ski resorts, farming ventures, cigarette sales and gaming through unincorporated tribal entities. There is no separation of the business entity from the tribal government body and such enterprises do not hold assets or property separately from the tribe. Land and assets used by the unincorporated enterprise are held by the tribal political body and are not specifically conveyed or set aside. In some instances, there are no separate bank accounts, separate directors, or assets.<sup>9</sup> The enterprise is wholly-owned by the tribe. The tribal council is typically involved in day-to-day management decisions either directly or indirectly.

For example, the Navajo Nation formed the Navajo Forest Products Industries (NFPI) which is wholly-owned and operated by the tribe on the Navajo Reservation.<sup>10</sup> NFPI is an instrumentality or arm of the tribal government. The enterprise manufactures wood products. NFPI conducts day-to-day operations and is supervised by a general manager who is appointed and responsible to a nine-member management board. The board is appointed by the Navajo Tribe's advisory committee which is ultimately responsible for the operation of the business enterprise. The advisory committee is comprised of the Navajo Tribal Council.

Researchers with the Harvard Project have described the unincorporated tribal instrumentality as a Council-Run Model.<sup>11</sup> *See adapted diagram below.*

## The Tribal Instrumentality Model



- The Council sits on the Enterprise Board and is involved in day to day management of the business.
- The board (if it exists) advises the Council and the CEO about strategy but generally has no power to act on important corporate policy issues.

### 3. Sovereign Immunity and Liability Issues

**Sovereign Immunity**--As a matter of federal law, judicial relief to enforce contracts or agreements against an Indian tribe in state or federal court is permitted only where Congress has authorized the suit or the tribe has waived its immunity.<sup>12</sup> Sovereign immunity protects the limited and irreplaceable tribal resources from large judgments and safeguards tribal self-governance. The doctrine of sovereign immunity recognizes that a tribe's sovereign status is directly related to its ability to generate revenues through the regulation of commercial activities on the reservation. The ability to contract impacts a tribe's fiscal resources by binding or obligating the funds and assets of the tribe. Therefore, courts have found that corporate contractual provisions are economic matters that directly affect a tribe's right to self-government. From this perspective, a tribal business entity under certain circumstances can be determined to be a tribe's alter ego and share the same attributes of tribal sovereignty as the tribe such as sovereign immunity from suit in order to protect tribal assets and property.<sup>13</sup>

Indian tribes possess the common-law sovereign immunity from suits similar to that enjoyed by other sovereigns.<sup>14</sup> Tribal enterprises which serve as subordinate economic tribal entities created by an Indian tribe possess attributes of sovereignty such as sovereign immunity. Consequently, they cannot be sued absent a clear waiver of sovereign immunity.<sup>15</sup> Indian tribes are generally immune from suits on contracts that involve governmental or commercial activities on or off a reservation.<sup>16</sup> A business entity that is an instrumentality or arm of the tribe or an unincorporated entity of a tribe

can share the same attributes of the tribe including sovereign immunity from suit. When a tribe establishes an entity to conduct certain activities, the entity is immune from suit if it is functioning as an arm of the tribe such that its activities are appropriately deemed to be those of the tribe.<sup>17</sup> Courts have rejected attempts to limit sovereign immunity to the governmental activities of a tribe and have found tribes to be immune from suit for business activities if operating as an arm of the tribe.<sup>18</sup> A tribal instrumentality or unincorporated enterprise of a tribal government, however, can not unilaterally act to waive tribal sovereign immunity except in accordance with tribal law.<sup>19</sup>

Tribal commercial enterprises cover a broad range of activities that include gaming, smoke shops, convenient stores, business parks and other enterprises. Many courts have found that subordinate economic entities of the tribe created for commercial purposes share the same immunity as the tribe itself.<sup>20</sup>

Tribal sovereign immunity can create uncertainty and risks for would-be investors or business partners. For instance, agreements may not be enforceable where one party (e.g., a tribe or tribal entity) is immune from suit.

In many disputes regarding tribal commercial activities, an issue is raised regarding whether a tribe has waived sovereign immunity. An Indian tribe cannot be sued unless there is a clear waiver of sovereign immunity by the tribe itself or a clear abrogation of immunity by an Act of Congress.<sup>21</sup> A tribe may waive immunity by contract or agreement, by tribal ordinance, by resolution, or by its corporate charter. Such waiver must be in accordance with valid tribal law, such as a constitution and by-laws, by tribal code, or other provision which authorizes the waiver and permits tribal officials to execute contracts.<sup>22</sup>

Tribes have granted limited waivers of sovereign immunity. Waivers can be limited in a number of ways. A waiver can be limited to (1) a specific tribal asset or enterprise revenue stream, (2) a specific type of legal relief sought by performance of the contract and not money damages, (3) a claim limited to the amount borrowed, or (4) a specific enforcement mechanism, such as court or arbitration.

The Supreme Court has recently construed an arbitration clause contained in a contract executed by a tribe as constituting a clear waiver of sovereign immunity.<sup>23</sup> In this instance, the tribe entered into a contract that did not contain an express waiver of sovereign immunity or express consent to state court jurisdiction. Rather, the contract contained an arbitration provision in which the tribe agreed to arbitrate claims under the contract, agreed to the governance of state law, and agreed to the enforcement of the arbitrator award in "any court having jurisdiction." The Court concluded that the tribe waived immunity from suit and enforcement of the arbitration award with requisite clarity.

When a tribe engages in commercial activities as an unincorporated arm of the tribal government, it will need to address questions regarding tribal sovereign immunity. When a tribe enters into a commercial endeavor it is investing its time, energy, and

resources, and its business partner is doing the same. It is a reasonable business practice for all parties to want to protect their business investments. Tribal sovereign immunity can prevent a lender or business partner from protecting its investment. Whenever a tribe or an unincorporated instrumentality of the tribe enters into a contract or agreement, sovereign immunity is implicated. A lender or business partner will likely seek a method to protect its investment through a limited waiver of sovereign immunity. The decision to waive immunity is a governmental decision.

One of the disadvantages of forming a tribal business entity as an unincorporated instrumentality of a tribal government is that the sovereign status of the tribe may impede a tribe's ability to obtain credit and financing for its business transactions if agreements are not enforceable through judicial action. Also, if a tribe does waive its immunity from suit through a tribal instrumentality, it may subject the assets of the tribe to potential liability for the obligations of the tribal instrumentality. Since there is no separate legal entity conducting business, the assets and obligations of the tribe are intermingled with the business.

#### 4. Tax Treatment

**Tax Treatment**--There is no federal statutory provision that exempts Indian tribes from federal income taxation. However, the Internal Revenue Service has concluded that federally recognized tribes and their federally-chartered corporations are not subject to federal income taxes.<sup>24</sup> With respect to tribal governments, the IRS in Revenue Ruling 67-284 based its conclusion on the fact that tribes are political bodies that Congress did not intend to include within the meaning of taxable entities subject to the income tax provisions of the Internal Revenue Code regardless of whether the business activity is inside or outside of Indian-owned lands. With respect to tribal federally-chartered corporations, the IRS takes the view that no taxable entity separate from the tribe exists. Any income earned by a tribe is not subject to federal income tax regardless of whether a tribal business activity is on or off Indian-owned lands.<sup>25</sup> The federal tax treatment of a tribal enterprise will depend on how a business is structured.

The IRS has generally treated an unincorporated instrumentality or business operated directly by a federally recognized tribe as not subject to federal income tax, again because it is not considered to be an entity separate from the tribe itself. As a note of caution, there is no per se exemption from federal income taxation when a tribe organizes as an "instrumentality." To be considered a nontaxable entity, the instrumentality must be operating as an arm of the tribe, and not organized as a separate legal entity. In determining whether an entity qualifies as a government instrumentality, the IRS generally looks at the following six factors:

- 1) whether the organization is used for a governmental purpose and performs a governmental function;
- 2) whether performance of its function is on behalf of one or more governmental units (e.g., a state, a tribe or political subdivision);

- 3) whether there are any private interests involved, or whether the governmental unit has the power and interest of an owner;
- 4) whether control and supervision of the organization is vested in a public authority or authorities;
- 5) whether express or implied statutory or other authority is necessary for the creation and/or use of the organization, and whether this authority exists;
- 6) and the degree of financial autonomy of the entity and the source of its operating expenses.<sup>26</sup>

If it meets this multi-factor test, an instrumentality will qualify for tax benefits reserved to governmental entities--such as the ability to receive charitable contributions or to issue tax exempt bonds.

Recognizing that for some purposes tribal governments have similar qualities to state governments, Congress passed the Indian Tribal Governmental Tax Status Act in 1982 to provide similar governmental tax treatment to tribes.<sup>27</sup> The Tribal Governmental Tax Status Act, codified as section 7871 of the Internal Revenue Code, provides that federally recognized tribes are treated like states for purposes of a number of tax benefits, including:

- Charitable contributions are tax deductible
- Gifts and bequests are deductible
- Tax exempt bonding authority
- Exemption from certain excise taxes
- Treatment as a government under the private foundation excise tax rules.

Although Code Section 7871 did not codify the basic tax immunity of tribal governments, the legislative history indicates that Congress was aware of the Internal Revenue Service's position and did not wish to alter it.

## 5. Financing Considerations

Two major considerations in obtaining credit through conventional lending are: (1) the lenders need to be able to enforce an agreement, and (2) they need to protect their investment in the event of a default. A tribe operating an enterprise as an arm of the tribal government may have difficulty obtaining conventional financing.

**Ability to enforce agreements**--Lenders will be reluctant to provide credit if they are not certain that they can enforce their contract against a tribal enterprise that is an arm of the tribe because, like the tribe, it will be immune from suit. A tribe and lender can address this in a number of ways. The tribe can waive sovereign immunity for a particular transaction. Or, as addressed later in this Handbook, the tribe can form an

entity separate from the tribal governing body that does not have sovereign immunity from suit or which has been vested with limited sovereign immunity.

**Collateral and Security Interest**--In addition to sovereign immunity concerns, a conventional lender will also want collateral or a security interest so that its investment is protected if there is a default or the enterprise is not successful. An enterprise operating as an unincorporated instrumentality of the tribe and its governing body will not have separate assets or property to pledge as collateral. Rather, tribal assets would have to be pledged and there will be no limitation of liability.

### **Loan Guarantee Programs:**

**U.S. Department of the Interior Capital Investment Program.** The Department of the Interior, Office of Indian Energy and Economic Development ("IEED") has an "Indian Affairs Loan Guaranty, Insurance, and Interest Subsidy Program" with two key loan programs. The first is a loan guaranty program in which a loan from a lender to a Tribe or an Alaska Native group may be provided a guaranty of up to 90% of a loan if the business activity will contribute to reservation economic development.

The IEED does not make direct loans. Loans may be made to finance Indian-owned businesses organized for profit, provided that Indian ownership constitutes at least 51% percent of the business. In 2006, the maximum loan amount that could be guaranteed for tribes is \$12 million dollars. Each year Congress determines the limit on the total amount that IEED may guaranty. In 2006, the Office of IEED had \$107 million dollars. In recent years, the Office of IEED has exhausted its limit before the end of the fiscal year. In some circumstances, IEED may subsidize the interest rate guaranty under the program by paying the difference between the yield on outstanding obligations of the United States of comparable maturity and the rate the bank is charging the Indian borrower.

The second is a new loan insurance program that may provide a more efficient process for tribally-owned firms to obtain loans under the \$250,000 amount and at a lower cost than the IEED loan guaranty program. Under the insurance program, a bank that has been certified for the program may issue loans up to \$250,000 to tribal firms without obtaining IEED approval. The IEED fees for this program are 1% less than the guaranteed loan program. Under this program, IEED will insure the lesser of 90% of the loan or 15% of the total dollar amount of the bank's loan portfolio issued under the insurance program.

**U.S. Department of Agriculture ("USDA") Business & Industry ("B&I") Loan Guarantee Program.** The Business & Industry Loan Guarantee Program is intended to improve, develop, or finance business, industry, and employment, to improve economic conditions in rural communities. The guarantee fee charged, which may be passed on to the borrower, is two percent of the original loan amount. The fee may be reduced to one percent if certain criteria are met. Eligible borrowers include Indian tribes or federally recognized groups.<sup>28</sup>

Loan proceeds can be used for machinery and equipment, buildings and real estate, working capital, and certain refinancing. Generally, the maximum amount available to a borrower is \$25 million; however, the maximum amount for rural cooperatives processing value-added commodities is \$40 million. The USDA will guarantee up to 90 percent of the amount of the loan under \$2 million, 80 percent of a loan between \$2 million and \$5 million, 70 percent of a loan over \$5 million, and 60 percent of a loan over \$10 million.

**Small Business Administration ("SBA") 7(a) Program.** The SBA 7(a) Program provides commercial loan guarantees to American small businesses for general business purposes.<sup>29</sup> Loan proceeds may be used for working capital, machinery and equipment, furniture and fixtures, land and buildings, leasehold improvements, and certain refinancing. The loan term is up to 10 years for working capital, and up to 25 years for fixed assets.

7(a) loans are only available on a guaranty basis. This means they are provided by lenders who choose to structure their own loans by SBA's requirements and who apply and receive a guaranty from SBA on a portion of this loan. The SBA does not fully guaranty 7(a) loans. The lender and SBA share the risk that a borrower will not be able to repay the loan in full. The guaranty is a guaranty against payment default.

Tribally-owned businesses may be eligible to receive loan guarantees if they meet other SBA requirements regarding size, nature of the business, use of proceeds, and lack of available credit elsewhere. SBA regulations provide that businesses deriving more than one-third of their gross annual revenue from "legal gambling activities" are ineligible to for SBA loans.<sup>30</sup>

**Tax-exempt Bonding.** Section 103 of the Tribal Governmental Tax Status Act permits tribal governments to issue tax exempt bonds. When a tribe issues tax exempt bonds, the investors in such bonds are able to earn interest free of tax. Thus, all other factors being equal, such bonds should yield lower interest rates than taxable debt. Bond financing (whether taxable or tax-exempt) also has the advantage of allowing the borrower to spread repayment of principal and interest over a longer period.

Only Indian tribal governments and their political subdivisions are qualified issuers of tax exempt debt. Furthermore, the IRS has ruled privately that certain entities that qualify as "integral parts" of the tribe may also issue such debt.<sup>31</sup> In addition, the IRS has ruled that Indian entities qualifying as an "instrumentality" of one or more government units may use tax exempt financing, and such use will not constitute a "private business" use.<sup>32</sup>

In addition to meeting these tests, which focus on the identity of the person issuing the bonds (or on whose behalf the bonds are issued), all tribal tax-exempt debt must finance facilities that serve an "essential governmental function." Section 7871 does not define an essential government function, but Section 7871 states that it does not include functions not customarily performed by state or local governments. The



interpretation of the "essential governmental function" test has spawned a number of controversies between the IRS and tribes. Recently, the IRS announced a proposed rulemaking to bring more clarity to this area of the law.<sup>33</sup>

**Tax Credit Financing.** The Energy Policy Act of 2005 includes authority for nonprofit utilities and governmental entities, including tribal governments, to issue tax credit bonds to finance the cost of renewable energy projects--known as Clean Renewable Energy Bonds ("CREBs"). These entities may issue a total of up to \$800 million in tax-credit bonds between January 2006 and the end of December 2007 to finance solar, wind, biomass, landfill gas, geothermal, and small irrigation power facilities that generate electricity. No more than \$500 million of the CREBs can be allocated for projects of government entities. The project must be owned by a governmental entity or non-profit entity. Initial applications for allocation of these bonds were due April 26, 2006.

H.R. 6408, the Tax Relief and Health Care Act of 2006, recently extended and expanded the availability of CREBs. Section 202 of the bill authorizes an additional \$400 million of CREBs and extends the authority to issue such bonds through the December 31, 2008. The bill is expected to be signed into law by President Bush. Assuming that the bill is enacted, it is expected that there will be a new round of applications that eligible issuers may submit.

**Project Financing/Non-Recourse Debt Financing.** Project financing involves non-recourse financing of the development and construction of a particular project in which a lender looks primarily to the revenues expected to be generated from the project for the repayment of its loan and to the assets of the project as collateral for its loan rather than the general credit of the project owner or developer. Capital-intensive projects requiring large investment of funds such as power plants, pipelines, and power generation facilities, are increasingly funded using project finance. Developers of these projects are frequently not sufficiently creditworthy to obtain traditional financing or are unwilling to take the risks and assume the debt obligations for traditional financing.

Project financing permits the risks associated with such projects to be allocated among a number of parties at levels acceptable to each party. For example, for an energy generation facility, there usually has to be a long-term off-take agreement or power sales agreement and the purchaser has to have good credit.<sup>34</sup> A tribe developing wind power generation may obtain a power sales agreement from a utility who agrees to purchase the power generated by the project for a stated term. Any utility that agrees to purchase the product must have good credit. The power sales agreement and the anticipated revenues could be pledged as security to obtain a loan for the construction and development of the project. The tribal developer would not have an obligation to make payments on the project loan if the revenues generated by the project are insufficient to cover the loan payments. This type of financing allows the developer to finance the project on a highly leveraged basis. Often, projects are financed using 80 to 100 percent debt financing. A developer's funds are at less risk as it permits a developer to finance the project without diluting its equity investment in the project.

## 6. Advantages and Disadvantages

**Advantages and Disadvantages**--It can be challenging for a tribe that chooses to operate and manage a commercial enterprise through an unincorporated arm of the tribe. Since an unincorporated commercial enterprise of the tribe is acting as an extension of the tribe it is not set up as a separate legal entity from the tribe itself. The tribe will enter into a contract in its own name. The assets and property of unincorporated enterprise is not conveyed to a separate legal entity and can not be separately pledged as collateral. Thus it is more difficult to minimize the financial risks of the tribe by segregating the assets of the unincorporated enterprise.

The advantages of operating a business as an unincorporated instrumentality of the tribe include:

- Easy to form since it is formed as an arm of the tribal government--no need to set up a separate legal entity
- Management is centralized through tribal governmental officials
- Entity will have the same privileges and immunities as the tribal government including tribal sovereign immunity
- Not subject to federal income tax
- Section 81 approval by the Secretary of the Interior required if contracts or agreements encumber Indian land for a term of 7 years or more.

Disadvantages include:

- Politics and business not separated
- Assets and liabilities of the enterprise are not segregated from governmental assets
- Wholly-owned tribal entity--would preclude equity ownership in enterprise by outside investors.

A major disadvantage of an unincorporated instrumentality of the tribe is that it does not separate politics from the day-to-day business operation of the tribe and the tribe assumes liability for all of the obligations and liabilities of the enterprise. This can result in micro-managing of a business enterprise which may hinder the tribal council's ability to set overall strategic economic development objectives.

### **Case Study—Mohegan Tribal Gaming Authority**

In 1995, the Mohegan Tribe of Indians of Connecticut, a federally-recognized tribe, adopted a tribal ordinance that established the Mohegan Tribal Gaming Authority as an instrumentality of the tribal government. The Authority was created under an ordinance established under tribal law.

The Authority is governed by a Management Board comprised of the same nine members that serve on the Tribal Council. The nine-member Tribal Council serves four-year staggered terms; any change to the Tribal Council results in a corresponding change to the Management Board. The Authority is managed by a CEO who is hired by the Management Board. The CEO makes the day-to-day business management decisions for the Mohegan Sun.

The Authority has been granted the exclusive power to conduct and regulate gaming activities on the existing reservation of the Tribe and non-exclusive authority to conduct activities elsewhere. In 1996, the Authority opened the Mohegan Sun casino and entertainment center on their reservation. In 2005, the Authority purchased a racing facility and five off-track wagering facilities in Pennsylvania, and formed the Mohegan Sun at Pocono Downs.

The Authority has wholly-owned subsidiaries: Mohegan Basketball Club LLC, Mohegan Ventures-Northwest LLC, and Mohegan Commercial Ventures PA, LLC. As part of its diversification efforts, Mohegan Ventures-NW owns a 54.15% in Salishan-Mohegan LLC, formed with an unrelated third party to participate in the development and management of a casino to be owned by the Cowlitz Indian Tribe in Washington. Both Mohegan Ventures-NW and Salishan Mohegan are designated as unrestricted subsidiaries of the Authority and are not required to be guarantors of the Authority's debt obligations.

Source: Mohegan Sun Casino and Tribal Gaming Authority 2005 Annual Report.

## Case Study—Eagle Tech Systems

Eagle-Tech Systems (ETS) is a wholly-tribally owned computer services company. Originally started in 1972 as an internal information technology department by the Warm Springs tribal government, it was renamed ETS in January 2004. The ETS office is located on the Warm Springs Indian Reservation in North Central Oregon.

The Confederated Tribes of the Warm Springs Reservation is a confederation of three Indian tribes organized pursuant to the Indian Reorganization Act of 1934 (IRA). The Tribe has both a Constitution and Bylaws approved pursuant to Section 16 of the Act and a federal corporate charter issued pursuant to Section 17 of the Act. In both capacities it is governed by an 11 member tribal council. The Tribe has approximately 4,500 members. Its lands include 640,000 acres within the reservation boundaries, and some thousands more acreage off reservation within its original lands ceded to the U.S. Government in 1855. It has a variety of enterprises including a lumber mill, vacation resort, casino, composite materials manufacturing plant, museum, construction enterprise, credit enterprise, and hydroelectric power generation enterprise. Some of these are formed under the federal corporate charter and others, like Eagle-Tech Systems (ETS), are formed pursuant to provisions of the constitution.

Eagle-Tech Systems is not a corporation, partnership, LLC, LLP, sole proprietorship or other form of legal organization commonly used off the reservation. Rather, it is a unique entity formed under the Tribal Constitution that has many of the attributes of the most common forms of business organizations. The Tribal Constitution empowers the Tribal Council "to charter subordinate organizations for economic purposes and to regulate the activities of all cooperative associations of members of the Confederated Tribes." Pursuant to this provision the Tribal Council, by resolution, has chartered Eagle-Tech Systems as a "subordinate organization for economic purposes." Under the charter, it is governed by a board of directors appointed by the Tribal Council. It is managed on a day-to-day basis by a General Manager selected by the board of directors. As a legal entity, it can be described as a "subordinate organization of the Warm Springs Tribe chartered for economic purposes by the Tribal Council of the Confederated Tribes of the Warm Springs Reservation pursuant to the provisions of its Constitution adopted pursuant to the provisions of Section 16 of the Indian Reorganization Act of 1934".

Source: Eagle Tech Systems

## **B. Political Subdivision of Tribal Government**

Political subdivisions are increasingly utilized by Indian tribal governments as quasi-business entities because of the close link between economic development (a governmental function) and tribal ownership and conduct of businesses. In some cases, such subdivisions are being formed as Economic Development Authorities that serve two functions: (1) as holding companies for business entities owned by the tribe; and (2) as regulatory bodies for business operations within the tribe's jurisdictional area. In other cases, political subdivisions are utilized to own and operate a specific enterprise or activity that has both a governmental and a business aspect to it, such as energy development, gaming or housing.

### **1. Brief Description and Examples**

A political subdivision of an Indian tribal government is a unit of the government that:

- Is, to some degree, separate from the government itself
- Is created under tribal law to fulfill a substantial governmental function of the government
- Has been delegated a sufficient amount of one or more recognized sovereign powers of the tribe.

Recognized sovereign powers include, for the purpose: (1) the power to tax; (2) the power of eminent domain; and (3) a police or regulatory power.

This past year, the IRS ruled that a tribal business development authority (the "Authority") may constitute a political subdivision of a federally recognized Indian tribe (the "Tribe"). In Private Letter Ruling ("PLR") 200635002, the Tribe, through its Tribal Council, established the Authority as a political subdivision of the Tribe. Authority was given the power to impose and collect (1) business income or franchise taxes, sales and use taxes, and other business-related taxes on any persons (limited to business entities chartered by the Tribe), transactions, or activities within Tribe's taxing jurisdiction, and (2) service and licensing fees on business enterprises operating within Tribe's taxing jurisdiction.

The Tribe retained significant control over the Authority even though it was a separate entity. For example, it provided that all five members of Authority's governing board could be removed by the Tribal Council at any time with or without cause. Furthermore, the Authority's capital and operating budgets were subject to Tribal Council approval before they became effective, while financial balance sheets and quarterly reports were required to be filed with the Tribal Council.

The IRS found the Tribe effectively delegated all the power to tax, and one or more of the substantial governmental functions within the meaning of section 7871(d) of the Code. Therefore, the IRS held Authority will be treated as a political subdivision of Tribe under section 7871 of the Code.<sup>35</sup>

Other examples of political subdivisions that have been recognized as such by the IRS and the Bureau of Indian Affairs ("BIA") include the following:

- A reservation infrastructure development authority or entity
- Numerous tribal housing authorities, including an intertribal housing authority
- An intertribal river protection and fish commission
- An industrial development commission charged with the administration and development of economic activities within tribal jurisdiction.

In certain instances, the IRS has ruled that a tribal entity did not qualify as a political subdivision. For example, the IRS ruled in the late 1990s that a state-chartered non-profit health entity was not a political subdivision of an Indian tribe because there was no evidence tribe had delegated any sovereign powers to the entity. Conversely, the IRS ruled in the mid-1980s that a tribal tax commission was not a political subdivision--not because it lacked sovereign powers, but because it was an "integral part" of the government itself.<sup>36</sup>

## 2. Organizational Characteristics and Requirements

Most entities that qualify as political subdivisions of a tribal government are created under tribal law (generally, through a special purpose ordinance or legislative act) for a governmental purpose. Although political subdivisions are ultimately controlled by the tribe and its governing body, such subdivisions generally have their own governing body--whether it be a board of directors, a commission or other type of decision-making body. As noted above, the hallmark of a political subdivision is its ability to exercise sovereign powers delegated to it by the tribe.

Section 7871 of the Internal Revenue Code provides that a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the IRS determines (after consultation with the Department of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial government functions of the Indian tribal government. The legislative history provides that sovereign powers of an Indian tribal government include the power to tax, the power of eminent domain, and police powers (such as control over zoning, police protection, and fire protection).<sup>37</sup> Police powers generally include the power to promulgate and enforce regulations within an entity's scope of authority.

Following passage of the Indian Tribal Government Tax Status Act in 1982, the IRS promulgated two revenue procedures relevant to tribal political subdivisions. The

first--Revenue Procedure 84-36--lists all of the tribal entities that the IRS determined to be political subdivisions at that time. The second--Revenue Procedure 84-37--provides specific procedures that must be followed by any tribe seeking to qualify an authority or subordinate entity as a political subdivision.<sup>38</sup>

*Comment: Tribal political subdivisions are not required by the IRS or BIA to obtain official recognition of their status for federal income tax purposes, but if a tribal political subdivision intends to be treated like a political subdivision of a state for all of the enumerated federal tax benefits in Section 7871 (e.g., authority to issue tax-exempt bonds, entitlement to various excise tax exemptions, ability to receive tax-deductible charitable contributions), it must request an IRS ruling following specific IRS procedures.*

Under the procedures set forth in Revenue Procedure 84-37 as updated annually by subsequent IRS revenue procedures,<sup>39</sup> the first step in obtaining an IRS ruling on the political subdivision status of a tribal entity is to secure a letter from the Department of the Interior ("DOI") verifying that the Tribe has delegated a substantial government power to the entity. The DOI letter may be obtained from the Solicitor's Office at the Department. There are no regulations or other administrative pronouncements on the format for the DOI letter request, other than the substantive guidance found in the IRS revenue procedures. The request should demonstrate that the subdivision has been validly established under tribal law and that the tribe's governing body has delegated one or more of the following three sovereign powers to the entity: (1) the power to tax; (2) the power of eminent domain; and (3) a police power. There is no filing fee for requesting the DOI determination letter, but such determinations generally take at least 90 days to obtain.

Once the DOI letter has been issued, the IRS ruling request may be filed. Even though the IRS is not required to make a substantive determination of its own, the IRS charges the normal private letter ruling "user fee" for political subdivisions determinations. As of February 1, 2006, the user fee was \$10,000. This type of private letter ruling will normally be processed in 90 to 120 days if all of the technical requirements are met.

### 3. Sovereign Immunity and Liability

Sovereign immunity generally extends to political subdivisions of Indian tribal governments. Like an instrumentality, a tribal political subdivision shares the same attributes of tribal sovereignty as the tribe. Sovereign immunity is essential in order to protect tribal assets and to safeguard tribal self-governance.

When a political subdivision is utilized for economic development purposes, there are likely to be occasions in which the subdivision finds it useful or necessary to execute a limited waiver of sovereign immunity. Thus, the tribal ordinance establishing the

subdivision should provide that the subdivision may execute any limited or transaction-specific waiver of its sovereign immunity. Limitations on the subdivision's exercise of such a right typically include (1) requiring advance approval of the Tribe's governing body, and (2) clarifying that a subdivision's waiver of immunity does not in any way waive the tribe's immunity. In addition, in establishing a subdivision, it is useful to provide that the subordinate entity's immunity from suit does not extend to legal actions against it or its officers or directors brought by the tribe itself.

#### 4. Tax Treatment

The IRS has ruled that the income earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision "is generally not taxable in the absence of specific statutory authorization for taxing such income."<sup>40</sup> As noted above, the IRS has taken this same approach to the taxation of income earned by Indian tribes, their unincorporated businesses, and their section 17 corporations.<sup>41</sup> The IRS has also ruled privately that a political subdivision of an Indian tribe was not required to file income tax returns.<sup>42</sup>

*Comment: Although the relative dearth of binding IRS authority on the income tax treatment of tribal political subdivisions is troubling, the current practice of the IRS is to treat political subdivisions the same as the tribe—so long as they qualify as such by having been delegated substantial governmental powers.*

Section 7871 treats Indian tribal governments and their political subdivisions like state governments for specific tax purposes. The Internal Revenue Code provides a relatively large number of tax benefits for state and local governments. Not all of these benefits are extended to tribal governments. Under Section 7871, the following benefits are available to tribal governments and their political subdivisions:

- Tax deductibility of charitable contributions for income, estate and gift tax purposes
- Certain governmental exemptions from specific excise taxes levied on fuels, manufactured goods, communications, and certain highway vehicles (all contingent on the purchase or sales transaction involving the exercise of an "essential governmental function")
- Tax deductibility of tribal taxes
- Authority to issue tax-exempt bonds for facilities that serve an "essential governmental function"
- Certain health and retirement annuity plan purposes (but not the treatment of tribal pension or retirement plans generally as "governmental" plans)
- Excise taxes rules related to excess lobbying expenditures and private foundations.



In addition, under section 7871(a)(5), Indian tribal governments or their subdivisions that form colleges and universities are--like state colleges and universities--subject to the unrelated business income tax or "UBIT" (even through state political subdivisions would not generally be subject to the UBIT tax).

As noted above, in order to qualify for the tax benefits enumerated in Section 7871, a political subdivision of a tribe must be recognized by the Internal Revenue Service as an entity that has been delegated one or more sovereign powers of an Indian tribal government.

## 5. Financing Considerations

One of the major advantages of establishing a political subdivision for economic development or business activities is that such an entity can be both the borrower and the issuer in a tax-exempt financing. When the subdivision, and not the tribal government itself, is the issuer/borrower, overly invasive disclosure of tribal financial records may be avoided.

Where the facilities or operations to be financed do not meet the essential governmental function test under section 7871 for tax-exempt bond financing, the political subdivision may seek or arrange other types of financing, such as:

- Government-guaranteed loans
- Taxable bond issuances
- Private placements
- Commercial bank financing.

In addition, Indian tribes or their political subdivisions may seek specialized types of tax-credit financing (such as the "clean renewable energy bonds" recently authorized in the Energy Policy Act of 2005) and extended by the Tax Relief and Health Care Act of 2006.<sup>43</sup>

*These and other financing options are discussed in detail in Section II.A.5.*

## 6. Advantages and Disadvantages

Advantages of conducting economic development and business activities through a political subdivision include the following:

- Relative certainty of federal tax treatment
- Likely retention of state tax immunity
- Retention of sovereign immunity (except where waived or limited for specific purposes)

- Ability to form the equivalent of a corporate board with a governmental focus
- Use of the subdivision as both a regulatory body and as a holding company for subordinate and separately organized business entities.

Disadvantages of conducting economic and business activities through a political subdivision include the following:

- Time and expense associated with the formation of the entity, including the requisite federal agency approvals that must be obtained (first by BIA, and then IRS)
- Political subdivisions do not have all of the flexibility associated with ordinary business entities, such as corporations and LLCs
- Certain business partners may not be comfortable dealing with any type of governmental entity.

In sum, once an economic development or other authority is established as a political subdivision, it makes an excellent platform for both conducting and overseeing business operations. However, its formation is not likely to be quick and easy. Implementing this option requires careful advance planning and a minimum of six months to obtain the requisite agency approvals.

### III.

#### **TRIBAL CORPORATIONS**

##### **A. Tribally-Chartered Corporations**

Tribally chartered corporations have been utilized with increasing frequency by Indian tribal governments to conduct various types of economic development and business activities. One compelling reason for their use is that they are relatively easy to establish compared to federally chartered corporations (e.g., corporations organized under section 17 of the Indian Reorganization Act or section 3 of the Oklahoma Indian Welfare Act). In addition, tribally chartered corporations, unlike state chartered entities, are considered to be largely exempt from state regulation--depending, of course, on the locus of their operations and whether they are wholly owned by the tribe. They are also more likely to be immune from taxation than state-chartered corporations are. However, the federal tax treatment of such corporations is currently the subject of a pending IRS guidance project, and thus remains somewhat uncertain. In addition, the immunity from suit of such corporations depends on the facts and circumstances of their creation, ownership and operation, and can be difficult to predict.

##### **1. Brief Description and Examples**

A tribally chartered corporation is a corporation that is organized under a tribal statute or code or pursuant to a resolution of an authorized tribal legislative body. A corporation is a business entity that has the following characteristics: (1) limited liability (i.e., the liabilities of the corporation do not automatically become liabilities of the corporation's owners); (2) transferability of ownership interests; (3) centralized management, generally in the form of a board of directors; and (4) continuity of life (i.e., it exists until formally dissolved). By definition, a corporation has separate legal existence as an entity distinct from its owners or shareholders.

The tribe under whose laws a corporation is organized will typically issue a charter or certificate of organization. Such a corporation may be organized as a for-profit or nonprofit corporation. Ownership may be evidenced by shares (in the case of a stock corporation) or simply by governance control (non-stock corporation). Although for purposes of this chapter, we are focusing on tribally chartered corporations that are wholly-owned by an Indian tribe, such corporations may be owned in whole or in part by third parties so long the tribe's laws authorize the formation of such corporations.

The legal characteristics, capabilities and limitations of tribally-chartered corporations are all determined under the law of the chartering tribe. In some cases, such law may spell out the corporation's powers and limitations in great detail—especially where the tribe has taken the time to draft and promulgate a corporation code. In other instances, the tribal law merely establishes an entity for a specific purpose, and leaves the details to the organization's articles and bylaws.

Examples of tribally chartered corporations include the following (drawn from IRS rulings, reported cases and other sources):

- A tribally chartered college
- A tribal law corporation (or an instrumentality with corporate characteristics) used to conduct the gaming operations of the tribe
- A nonprofit corporation chartered by a tribe to provide educational and health programs for its members
- A tribally chartered corporation used as a holding company for a variety of economic development and business entities.

Numerous tribes have established and utilized tribal corporations for a wide variety of purposes.

## 2. Organizational Characteristics and Requirements

The organizational characteristics and requirements for a tribally chartered corporation will vary according to the applicable law of the tribe. Several tribes have adopted very detailed corporation codes (in some cases, with specific provisions for for-profit and nonprofit corporations), while others provide for the organization of tribal corporations on a more ad hoc basis. However, there are common characteristics and organizational procedures for forming and managing corporations that are found in many tribal statutes.

**Formation**--To form a tribally-chartered corporation, the incorporators must generally select a name and draft articles of incorporation. Most corporate codes require the following items to be included in articles of incorporation of any type of corporation:

- 1) the name of the corporation;
- 2) the term or period of existence of the corporation (which may be perpetual);
- 3) the purpose(s) for which the corporation is organized (with an eye toward consistency with whatever the tribe's corporation code define as lawful corporate purposes);
- 4) laws regulating the governance of the corporation, including the election of directors and rights of shareholders;
- 5) the address of the corporation's initial registered office and the name of its initial registered agent at such address;
- 6) the number of persons constituting the initial board of directors and the names and addresses of the persons who are to serve as directors;

- 7) the name and address of each incorporator;
- 8) provisions regarding the issuance and classes of stock by the corporation;
- 9) provisions relating to the payment of dividends; and
- 10) liquidation and dissolution procedures.

If a tribal corporation is owned in whole or in part by the tribe itself, the tribe's legislative body must formally approve its articles. If not, the articles are simply filed with the tribal official who is the equivalent to a Secretary of State. Such an official will review and approve the articles of the corporation, and then issue a "certificate of incorporation" or charter to the incorporators. Unless otherwise specified, corporate existence begins when the certificate of incorporation is issued by the government.

In the case of a wholly-owned tribally-chartered corporation, the corporation's articles will generally spell out the role of the tribe (as represented by the tribe's legislative body) in:

- Electing and removing the initial and successor directors
- Approving the initial articles of incorporation, and any amendments thereto
- Approving the entity's capital and operating budgets
- Negotiating any dissolution, liquidation or merger of the entity.

Other issues to be resolved in the corporation's organizational documents include the payment of earnings or corporate dividends to the tribe, and issues relating to sovereign immunity.

**Management**--Tribal law corporations are managed and overseen by a corporate Board of Directors who are elected by the corporation's shareholders. If the tribe is the corporation's sole shareholder (whether or not the corporation formally issues shares), the tribe's legislative body generally exercises the power to elect directors (and may remove them under certain circumstances). Directors approve budgets, approve the hiring of and set compensation for senior executive officers, establish the overall business strategy of the corporation, and hold its officers accountable for executing such strategy. A CEO or executive director is usually in charge of day-to-day operations.

### 3. Relationship to Tribal Government

When a tribe forms a wholly-owned corporation, it generally expects to retain overall control of the corporation while, at the same time, segregate the corporation's business affairs and assets from the operations of its government. Thus, while the tribe may be the sole shareholder of the corporation, the corporation will likely be managed by its own board of directors. The board of a tribal corporation will generally have some degree of autonomy from the tribe's elected leadership.

The extent to which a tribal law corporation has autonomy from the tribal government may determine in large measure whether it can claim to share the same immunity from suit as the government itself.

#### 4. Sovereign Immunity and Liability Issues

One of the key characteristics of any corporation is limited liability. In the corporate context, limited liability means that the shareholders of a corporation are generally not personally liable for the debts of the corporation in which they own stock. When a corporation is wholly owned by a tribe, the tribal corporation's organizing documents or other law should make clear that the tribe is under no obligation to the corporation or its creditors--other than to the extent of its contributed capital or other consideration for the shares that it owns. However, if a corporation that is wholly owned is not treated as a separate legal entity by its owner or if corporate formalities are ignored, the creditors of the corporation could seek to "pierce the corporate veil" in order to access tribal assets. *See Appendix B, Steps to Protect Corporate Veil and Limit Liability.* Anticipating the possibility of corporate veil piercing, many tribal corporation statutes, ordinances or organizing documents also make clear that by incorporating or operating a corporation, the tribe should not be deemed to have waived its sovereign immunity from suit or any other privileges of sovereignty.

In certain situations, corporations organized under tribal law may share the organizing tribe's sovereign immunity from suit. Courts have developed various methods of analysis for determining whether a particular tribally chartered corporation is immune. These inquiries tend to be highly fact specific which makes advance planning a difficult task. Still, several principles have emerged.

- Whether a judgment against the tribal corporation will reach the tribe's assets
- Whether the tribal corporation has the power to bind the tribe's assets or obligate tribal funds
- Whether the tribe and the tribal corporation are closely linked in governing structure and other characteristics, including
  - tribal control over appointment and removal of board members
  - extent of board's power over the corporation
- Whether federal policies designed to promote tribal self-determination are furthered by extending immunity to the corporation
- Whether the corporation is organized for governmental or commercial purposes
- Whether the corporation holds title to property in its own name
- Whether the entity is legally separate and distinct from the tribe (e.g., as is normally the case with a separately incorporated entity).

As a general rule, the more inter-connected the tribe and the corporation, the more likely a court will be to find that the corporation shares the tribe's immunity from suit. If the entity operates in a manner that is largely independent of the government, it is not likely to be able to cloak itself in governmental immunity. However, if the entity is a mere agent or instrumentality of the tribal government created to carry out a governmental purpose, it should be able to claim governmental immunity from suit. Such immunity may be waived, however, without waiving the tribe's immunity. For further detail. *See Appendix A, Sovereign Immunity Factors in Recent Judicial Decisions.*

## 5. Tax Treatment

While the IRS has consistently ruled that federally recognized tribes and federally-chartered tribal corporations (e.g., corporations organized by tribes under section 17 of the IRA or section 3 of the OIWA) are not subject to federal income tax, it has not charted a clear course with regard to the tax treatment of tribally-chartered corporations. In fact, for the past several years, the Treasury Department and the IRS have listed the federal tax treatment of corporations organized under tribal law as an official "guidance priority," but no guidance has been forthcoming.

The uncertainty over the tax treatment of tribal law corporations dates back to the issuance of Revenue Ruling 94-16 in 1994 and the subsequent issuance of regulations on the classification of business entities two years later in 1996. In Revenue Ruling 94-16, the IRS ruled that federally chartered tribal corporations should be treated the same as the tribe for federal income tax purposes, but that state-chartered corporations should be treated like ordinary corporations--taxable on their income and required to file federal corporate income tax returns. Revenue Ruling 94-16 did not address the tax treatment of corporations chartered under tribal law.

Following the issuance of Revenue Ruling 94-16, the IRS issued new regulations on the classification of business entities for federal tax purposes. These so-called "check-the box" regulations confirmed the tax-free status of Section 17 and Section 3 corporations. They did so by stating that such federally chartered entities, although generally meeting the definition of a "corporation," will not be recognized as "separate entities."<sup>44</sup> Thus, such corporations share the same tax status as the tribe. At the same time, in the 1996 preamble to these regulations, the IRS acknowledged the tax treatment of tribal law corporations was "unclear" and noted that the Treasury Department and IRS were studying the issue.<sup>45</sup>

In 2001, Treasury/IRS formally agreed to resolve the uncertainty regarding tribal law corporations in guidance to be issued by the IRS. Since then, the anticipated "guidance on the income tax status of wholly-owned corporations chartered under tribal law" has been an item listed on the annual Treasury-IRS Priority Guidance Plan. *See 2006-2007 Priority Guidance Plan (August 15, 2006) at <http://www.irs.gov/pub/irs-utl/2006-2007gp.pdf>.* The uncertain tax treatment of tribal law corporations has also been referenced in a recent addition to the Internal Revenue Manual, which reads as follows:

In addition, many tribes form corporations utilizing their own corporate code or resolution process. The tax status of corporations chartered under tribal law and owned 100% by the tribe is not clear. A revenue ruling is anticipated to address this issue.<sup>46</sup>

The resolution of this issue is still highly uncertain.

In the view of some commentators, the central issue is whether wholly owned tribal law corporations are exempt on a per se basis or only to the extent that such entities have been structured as "integral parts" of the tribe.<sup>47</sup> Prior to 2005, the IRS had issued private letter rulings treating certain tribally chartered entities the same as the tribe for tax purposes after determining that such entities functioned as an "integral part" of an Indian tribe.

Over the past several years, case law and IRS rulings have cited the following factors as relevant to the "integral part" determinations:

- Whether the government has the authority to terminate the existence of the entity
- Whether the government or a governmental body elects members to the entity's board
- Whether the government has the power to recall or remove the members of the entity's board
- Whether the government has made a significant financial commitment (or transferred significant property) to the entity
- Whether the government has a substantial right to the profits earned by the entity
- Whether the government is liable for acts of the entity
- Whether the entity is essentially an operating unit or agency of the government.<sup>48</sup>

In recent guidance issued in the form of private letter rulings, the IRS has highlighted two of these factors as being essential to establishing "integral part" status:

- 1) governance control; and
- 2) financial commitment.<sup>49</sup>

Thus, if a tribal law corporation is utilized for economic development purposes, the case for favorable tax treatment is strongest if the entity is structured to meet the "integral part" test. While the determination as to whether an enterprise qualifies as an integral part of the tribal government depends on all the facts and circumstances, it is



critically important to establish (1) the tribe's degree of governance control over the enterprise, and (2) the tribe's financial commitment to the enterprise.

It is difficult to predict whether the IRS revenue ruling that is expected to be issued in the next few months will continue to reflect this approach or chart a new course altogether.

The status of tribally chartered corporations under state tax law varies from state to state. Their status also may vary according to the type of tax involved.

In California, the only type of corporation that qualifies to be treated the same as the tribe for sales and use tax purposes is one that is "organized under tribal authority" and wholly owned by Indians or by the tribe itself; other types of corporations, even though they may be wholly owned by the tribe, apparently do not qualify for the special sales and use tax exemptions afforded to Indians, tribes and tribal organizations.<sup>50</sup>

In Oklahoma, the Oklahoma Tax Commission has taken the position that the sales tax exemption of Indian tribes does not extend to any "corporations, partnerships, or other business or legal entities," but "only applies to transactions with a federally recognized Indian tribe itself."<sup>51</sup>

## 6. Financing Considerations

Since it is not clear whether a tribally chartered corporation will be treated as an "integral part" of the tribe for federal income tax purposes, it is also unclear whether such an entity can issue tax exempt bonds. Under the terms of the applicable statutory provisions, only tribal governments and their political subdivisions can issue tax-exempt debt<sup>52</sup>. Further, depending on the activities of a tribally-chartered corporation, its use of tax-exempt bonds might be prohibited if they are issued to fund facilities or operations not deemed to serve an essential governmental function.

Where the facilities or operations to be financed do not meet the essential governmental function test under section 7871 for tax-exempt bond financing, a tribal law corporation may seek or arrange other types of financing, such as:

- Government-guaranteed loans
- Taxable bond issuances
- Private placements
- Commercial bank financing.

Recently enacted tax-credit bonds, such as those provided for "clean renewable energy facilities" ("CREBs") under the Energy Policy Act of 2005, are limited to Indian tribal governments and their political subdivisions.

The Small Business Administration ("SBA"), by contrast, generally favors the use of corporations and other business entities, rather than the conduct of business by tribal governments and their political subdivisions. To qualify for contracting preferences under Section 8(a), the tribe must organize a separate and distinct legal entity, that is "for-profit" and is capable of being sued. It may be organized under either state or tribal law. Thus, under SBA 8(a) rules, a tribal law corporation would be a viable choice if SBA preferences are being sought. If an SBA loan is sought, government-owned corporations generally do not qualify, but there is an exception for tribal government-owned entities.<sup>53</sup>

Under the Department of the Interior's Loan Guaranty, Insurance, and Interest Subsidy Program (administered by the Office of Indian Energy and Economic Development ("IEED")), any business entity that is at least 51 percent owned by a federally recognized tribe may qualify for a government-guaranteed loan.

*The IEED program and other financing options are discussed in detail in Chapter II.A.5.*

#### 7. Advantages and Disadvantages

Advantages of conducting economic development and business activities through a tribally chartered corporation include the following:

- Ease of formation
- Confirmation of tribal sovereignty and freedom from state corporate regulation
- Flexibility (ability to design own governance structure and rules)
- Possible tax immunity
- Possible immunity from suit.

Disadvantages of conducting such activities through a tribally-chartered corporation include the following:

- Uncertainty of federal tax treatment
- Certain business partners may not be comfortable lending to or investing in an entity that is not incorporated under the law of one of the 50 states
- Uncertainty whether the entity would qualify as an issuer in a tax-exempt financing
- Uncertainty whether the tribal corporation will be recognized as sharing the tribe's sovereign immunity.

In sum, a tribally chartered corporation is a flexible entity form that works well in many situations--e.g., where it is intended to operate principally on-reservation as an arm of the tribal government. It would not be the entity of choice for extensive off-reservation activities or as a joint venture entity involving non-tribal parties. The

continuing uncertainty surrounding its treatment for federal income tax purposes has diminished its attractiveness for many tribes.

#### **Case Study—Ho-Chunk, Inc.**

Ho-Chunk, Inc. is chartered under the laws of the Winnebago Tribe and is wholly-owned by the Tribe. The Winnebago Tribe is organized under Section 16 of the Indian Reorganization Act (IRA). Ho-Chunk, Inc. was formed in 1994 to diversify the Tribe's business interests while maintaining a separation between business activities and the tribal government. Pursuant to its Section 16 IRA constitution, the Winnebago Tribe adopted a Winnebago Business Code that permits the formation of wholly-owned tribal corporations. Incorporating under tribal law gives the tribe more control over determining the powers and authority of the corporation and which privileges and immunities of the tribe to confer on a tribal corporate entity. The Winnebago Business Code gives the Tribe the option of conferring all the privileges and immunities of the Tribe on tribally-owned corporations.

The Tribe formed Ho-Chunk, Inc. as a general purpose holding company that promotes economic self-sufficiency and creates jobs through its enterprises, joint ventures and investments. Operating subsidiaries can be formed under the tribal business code. The company has a five-member Board of Directors who is responsible for providing an annual report, audited financial statements and an annual development plan to the Tribal Council. Two of the board members are required to be tribal council members. The two tribal council members ensure that tribal governmental interests are maintained and they keep an informal channel of communication open with the Tribal Council. The Tribal Council appoints board members, formulates the long-term development plan for the corporation, and approves the annual operating plans. The Board of Directors selects the Chief Executive Officer who oversees day-to-day management and strategic decisions for the company. This structure preserves the autonomy of the corporation and permits the corporation and its Board to make business decisions and minimizes political interference by the Tribal Council. This permits the Tribal Council to focus on governance issues and enables business experts to focus on maximizing the profitability of the corporation. Ho-Chunk, Inc. operates 15 subsidiaries in six major business areas, both on and off the reservation.

Source: Ho-Chunk, Inc. and Harvard Project on American Indian Economic Development: Innovations Award.

## **B. Section 17 Corporation—Federal Law Corporation**

### **1. Description and Examples**

In passing the Indian Reorganization Act of 1934 (IRA), Congress intended to provide tribes with the ability to compete in the private business world. Section 17 of the IRA gives tribes the power to incorporate and enables them to waive sovereign immunity to facilitate business transactions, thereby fostering tribal economic development and independence.<sup>54</sup> Congress realized that the perception, if not the reality, of tribal sovereign immunity could impede a tribe's economic growth and participation in the business world. Therefore, to address this issue, Congress authorized tribes to organize two separate entities: (1) a political governing body to exercise powers of self-government pursuant to Section 16 of the IRA, and (2) a federally-chartered tribal corporation to engage in business transactions pursuant to Section 17.

Pursuant to the IRA, a Section 16 governmental unit and a Section 17 tribal corporation are distinct legal entities. By forming two legal entities (one with sovereign immunity, the other with the possibility of waiver of sovereign immunity), tribes could maximize the use of their property and assets. Under the two-part scheme, the property of the corporation may be placed at risk, but only to the extent necessary to satisfy the needs of lenders and developers; however, tribal assets held by the tribal political body organized pursuant to Section 16 of the IRA would remain fully protected by sovereign immunity.<sup>55</sup>

### **2. Organizational Characteristics**

**Formation**--Establishment of a Section 17 corporation is governed by a Section 17 of the IRA and by its implementing regulations.<sup>56</sup> However, neither the statute nor its regulations contain detailed procedures for forming a Section 17 corporation. Therefore, there is significant flexibility in how the procedural requirements are met and there is wide variation in the contents of tribal Section 17 corporate charters. Additionally, staff at the BIA Central, regional and local offices may have differing interpretations of the formation requirements particularly with respect to whether a tribe is required to submit a petition for a charter. Recently, the BIA Central Office has delegated more approval power to the Regional offices.

Traditionally, Indian tribes were required to take the following five steps in order to secure final approval of a federally-chartered Section 17 corporation.

**Step 1--Tribal Resolution or Petition.** The regulations provide that a tribe may initiate the Section 17 corporation formation process by submitting a petition to the Secretary of the Department of the Interior to issue a corporate charter. Prior to the 1990 amendments to Section 17, some agency personnel and attorneys interpreted the petitioning requirement to apply only to tribes with constitutions. Pursuant to recent BIA practice, the formation process may be initiated by tribes with or without constitutions--

simply by passing a tribal resolution for the issuance of a charter--without submitting a formal petition.

Step 2--Draft Charter. The next step is to draft the corporate charter, which is a document similar in form and scope to Articles of Incorporation, but generally with more detail. The charter describes the organizational framework for the entity that the tribe is seeking BIA approval. The corporation must be structured as a legal entity that is wholly owned by the tribe, but separate and distinct from the tribal government.

Step 3--Approval by the Tribe. Once drafted, the charter must be submitted to the tribe for approval. According to the BIA, the procedure for obtaining tribal approval is set by the law of the tribe, and not by federal law. If the tribe's constitution (or other organic documents) allows the Tribal Council to form corporations, a Council resolution is generally sufficient; if not, a vote of the general membership must be scheduled.

Step 4--Filing of Petition/Resolution. After the tribe signs the resolution or petition and approves the charter, both documents should be submitted to the local BIA office having administrative jurisdiction over the Tribe. Once received by the local BIA office, the documents will be reviewed to ensure that the submission is complete. If complete, the charter documents will be forwarded to the regional BIA office for further review and approval. (Under a recent delegation of authority, only if the regional BIA office proposes to disapprove the documents will they be forwarded to the Central or national BIA office for further review.) Upon a determination that the resolutions and proposed charter are consistent with tribal and federal law, and properly approved by the tribe, the Regional BIA office will issue an approved charter of incorporation.

Step 5--Ratification of Corporate Charter. Once the charter is approved, it will be returned to the Tribe for ratification. The Section 17 statutory provisions require that the corporate charter be ratified by the governing body of the tribe before it becomes effective. Once the charter is ratified by the Tribe, the statutory requirements are met and the charter becomes operable.

When Section 17 was first enacted, tribes were required to first organize a governing body under Section 16 in order to be eligible to organize a corporate entity under Section 17. The IRA was amended in 1990, and now tribes can form a Section 17 corporation regardless of whether they have formed their governing body pursuant to Section 16 of the IRA or pursuant to tribal law. Originally, the IRA did not apply to Alaska Natives or to Oklahoma tribes; it has subsequently been amended to extend to Alaska Natives and a similar provision was enacted for Oklahoma tribes.<sup>57</sup> The Oklahoma Indian Welfare Act (OIWA) authorizes the formation of tribal corporations in a manner similar to the IRA and extends to tribes organized under the OIWA any other rights or privileges secured to an organized Indian tribe under the IRA.<sup>58</sup> The 1990 amendments also extended the ability to form Section 17 corporations to tribes that voted to reject the IRA.

Neither the Section 17 statutory provisions nor the regulations provide guidance on how to amend a Section 17 corporate charter once it has been issued. For this reason, tribes frequently draft the corporate purposes section of the charter as broadly as possible to accommodate prospective changes in the Section 17 corporation's business activities and operation. In drafting the corporate charter, some tribes have vested tribal governing body (e.g., the Tribal Council) with authority to seek BIA approval of amendments as well as the authority to ratify such amendments. Once issued, a Section 17 corporate charter can not be revoked or surrendered, except by an Act of Congress.<sup>59</sup>

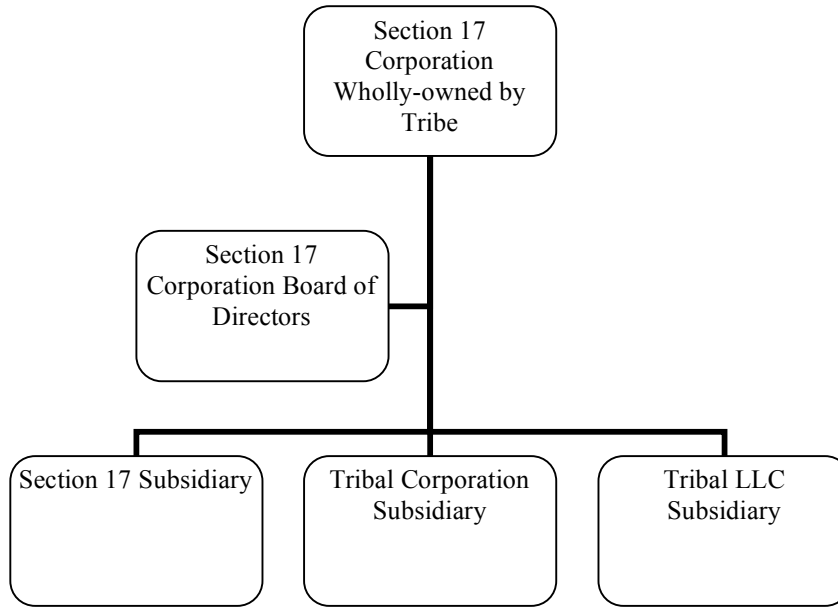
**Management**--Section 17 corporations are managed and controlled by a Corporate Board of Directors appointed by the tribal government. The Board of Directors manages and operates the Corporation in accordance with its federal corporate charter. A CEO or a manager is usually in charge of its day-to-day operations.

**General Characteristics**--Section 17 corporations are tribal in character, they must be wholly-owned by the tribe and are essentially alter egos of the tribal government. They share the same privileges and immunities as the tribal government. The corporate charters may convey the following powers to the incorporated entity:

- Power to buy and sell real and personal property; including the power to purchase restricted Indian lands
- To enter into leases or mortgages of tribal land for a term of 25 years without Section 81 approval by the Secretary of the Interior<sup>60</sup>
- To enter into contracts or agreements without Section 81 approval by the Secretary of the Interior<sup>61</sup>
- Further powers "as may be necessary to the conduct of corporate business."

A federal corporate charter often permits the corporation to establish and manage subsidiary corporations. Tribes have operated construction, manufacturing, gaming, and government contracting companies through Section 17 corporations. Section 17 incorporation provides a separation of the business entity from the tribal government body. A Section 17 corporation holds assets or property separately from the tribal governing body. Land and assets used by corporation are specifically conveyed or set aside for the corporation. A Section 17 corporation will typically have separate bank accounts, separate directors, and separate assets. Although the enterprise is wholly-owned by the tribe, the tribal council is typically not involved in day-to-day management decisions either directly or indirectly.

## Section 17 Corporation



- The Board of Directors of the Corporation has control over the direction and business activities of the Corporation
- The Tribal Council is not involved in the day-to-day activities of the Corporation, but rather sets strategic economic policies for the tribe.

### 3. Sovereign Immunity and Liability Issues

**Sovereign Immunity**--The Indian Reorganization Act (IRA) was intended to allow tribes to enter and compete in the business world. Understanding that sovereign immunity could be an impediment to enabling tribal governments to successfully compete in the business world by hampering the ability of tribes to obtain credit or attract investors, Congress authorized tribes to form a separate legal entity to engage in business activities: Under the IRA, a tribe may form a constitutional governing body pursuant to Section 16 and a tribal corporation to engage in business transactions pursuant to Section 17. Typically, a Section 17 corporate charter will vest the corporation with the same privileges and immunities of the tribe, including the tribe's immunity from suit. The charter will describe the authorized purpose of the corporation and whether the corporation is permitted to borrow money, encumber corporate assets, and whether it can waive sovereign immunity for certain transactions. The corporate charter usually describes the corporation's power to act, who can act on the corporation's behalf, the

ability of the corporation to waive sovereign immunity, to what extent corporate assets can be encumbered and what corporate actions can be undertaken without the approval of the tribe.

Section 17 corporate charters often contain a "sue and be sued clause." This clause usually permits the corporation to be sued in its corporate name. Some courts have held that this language constitutes a waiver of sovereign immunity of the corporation.<sup>62</sup> However, other courts have indicated that the inclusion of a "sue and be sued clause" does not constitute a waiver unless it is both unrestricted in scope and explicit in its intent to waive immunity.<sup>63</sup> The execution of a judgment against the corporation is limited to the business activities of the corporation and to "assets specifically pledged or assigned" to the corporation.

The BIA has drafted a model corporate Section 17 charter which provides that the "sue and be sued clause" of the charter is subject to limitations contained in the charter which restrict the scope of the waiver that can be granted pursuant to the "sue and be sued clause." Waivers of sovereign immunity pursuant to the "sue and be sue clause" in the corporate charter should be limited to a waiver of only the corporation's sovereign immunity and transactions of the corporation. These limitations include restricting the waiver to specific transactions or claims or classes of claims for which the waiver is granted, and that the waiver extends only to the property and income of the corporation and not to the tribe itself.

Even where there is a limited waiver, the IRA protects the assets of the tribal government from execution to satisfy a money judgment. Control over tribal assets is retained by the tribal governing body except where the tribal government specifically transfers assets or property to the Section 17 corporation.<sup>64</sup> A Section 17 Corporation has authority to convey or lease tribal lands that are assigned to the corporation for a period of 25 years. This permits the tribal government to pledge or assign specific assets to the corporation. This limitation allows a Section 17 corporation to enter into business transactions and to pledge a security interest in corporate assets. The property of the corporation is at risk in the amount necessary to satisfy creditors and developers. However, property owned by the tribal governmental body is still protected by sovereign immunity and is safe from the execution of a judgment against the corporation.

There are several court decisions concerning waiver of tribal sovereign immunity of a Section 17 corporation. Many of these decisions arise from the confusion created when a tribe has not clearly separated the business activities of its Section 16 governing body from the business activities of its Section 17 corporation. In these instances, the court is usually trying to determine in which capacity a tribe is acting. The court will look at who controls the decisions of the business, if the corporation has a separate bank account and its own liabilities, and if assets or property have been assigned to the corporation. If a court determines that tribe is acting in its governmental capacity, then the activities will likely be found to be beyond the scope of the Section 17 "sue and sued" waiver.<sup>65</sup>



#### 4. Tax Treatment

The Internal Revenue Service has concluded that federally recognized tribes are not subject to federal income taxes.<sup>66</sup> As noted earlier, the IRS has ruled that the income earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision "is generally not taxable in the absence of specific statutory authorization for taxing such income."<sup>67</sup> The IRS has taken this same approach to the taxation of income earned by Indian tribes, their unincorporated businesses and their federally chartered corporations because they share the same tax status as the tribe and as such are not taxable entities.<sup>68</sup>

In Revenue Ruling 81-295 and Revenue Ruling 94-16, the IRS ruled that any income earned by a federal corporation organized under Section 17 of the Indian Reorganization Act shares the same tax status as the tribe and is therefore not subject to federal income tax regardless of the location of the activities that generated the income.<sup>69</sup> Similarly, in Revenue Ruling 94-65, the IRS has ruled that a tribal corporation organized under Section 3 of the Oklahoma Welfare Act is not subject to federal income tax on income earned in the conduct of commercial business on or off the tribe's reservation.<sup>70</sup>

#### 5. Financing Considerations

One of the major advantages of establishing a Section 17 corporation for business activities is that such an entity can arrange for financing without subjecting the tribal governmental assets to the risks and liability associated with borrowing money and can limit financial disclosure of records to those of the corporation and not the tribe. Additionally, in a 1998 Private Letter Ruling, the IRS has held that a Section 17 corporation can be both the borrower and the issuer in a tax-exempt financing if other requirements for tax exempt financing are met.<sup>71</sup> When the Section 17 corporation, and not the tribal government, is the issuer/borrower, overly invasive disclosure of tribal financial records may be avoided.

Where the facilities or operations to be financed do not meet the essential governmental function test under section 7871 for tax-exempt bond financing, the Section 17 corporation may seek or arrange other types of financing--such as:

- Government-guaranteed loans
- Tax-credit financing
- Taxable bond issuances
- Private placements
- Commercial bank financing.

*These options are discussed in detail in Section II.A.5.*

#### 6. Advantages and Disadvantages

**Advantages and Disadvantages--**A Section 17 corporation can provide an attractive business structure for tribes because it establishes a legal entity to conduct and manage business activities separate from the tribe itself. It also segregates tribal governmental assets and liabilities from those of tribal businesses, minimizing the financial risks of the tribe. The assets and property of the business are conveyed to a separate legal entity and can be separately pledged as collateral. Thereby by limiting the liability of Section 17 corporation. It permits a tribe to tailor a waiver of sovereign immunity to fit the specific business activities that will be conducted by the corporation. It also safeguards the decision-making authority of the tribal government governments and assigns the responsibility for operating and managing business activities with the Board of Directors of the corporation and a business manager.

The advantages of operating a business as a Section 17 corporation include:

- Entity will have the same privileges and immunity as the tribal government including tribal sovereign immunity
- Segregates the assets and liability of the corporation from tribal assets
- Not subject to federal income tax
- Has 25 year leasing authority for tribal reservation lands and Section 81 approval by the Secretary of the Interior is not required
- Contracts and agreements of the corporation are not subject to Section 81 approval by the Secretary of the Interior.

Disadvantages include:

- The time to obtain a corporate charter issued by the Department of the Interior can be lengthy because of the various steps involved
- Once issued, the charter can only be revoked by an act of Congress
- A Section 17 corporation must be wholly-owned by the tribe--precluding equity ownership in the enterprise by outside investors.

### **Case Study—S&K Technologies, Inc.**

In 2006, the Confederated Salish and Kootenai Tribes formed S&K Technologies as a Section 17 Corporation. The tribal council passed a resolution approving the draft Charter and then submitted the draft Charter and petition to the Secretary of Interior to issue a charter. The corporate charter was then ratified by the tribe.

The Section 17 charter confers all the privileges and immunities of the tribe to S&K Technologies and permits the tribe to confer all privileges and immunity to tribally-owned subsidiaries chartered under the holding company. The S&K Technologies is a general purpose company and its corporate charter permits the corporation to charter subsidiaries under either the tribe's Tribal Corporation Code or under its newly adopted tribal Limited Liability Company Code. S&K Technologies is headquartered on the Flathead Indian Reservation in Montana. S&K Technologies plans to charter subsidiaries under the tribal LLC Code to operate its aerospace and information technology companies that are participating in the Small Business Administration 8(a) business development program. These tribal 8(a) LLCs will operate in Alaska, Georgia, Ohio, and the Pacific Northwest. The corporate charter is broadly drafted so that the corporation could also create other non-8(a) business entities.

S&K Technologies will be governed by a seven-member Board of Directors appointed by the Tribal Council to four year staggered terms and who are responsible for providing an annual report to the Tribal Council. The corporate charter does not restrict board appointments to tribal members or require that tribal council members be appointed to the board. The S&K Technologies Board of Directors will be responsible for hiring a CEO for each of the subsidiaries created under the holding company who will be responsible for day-to-day operations of the company. There will not be separate boards of directors for each of the subsidiaries; rather each CEO will report to the Board of Directors of S&K Technologies Corporation. This safeguards the decision-making authority of the Tribal Council and assigns the responsibility for operating and managing the business activities of the Section 17 Corporation to the business managers they hire. It permits business experts to focus on maximizing the profitability of S&K Technologies.

Source: S&K Technologies, Inc.



## IV.

### **STATE LAW ENTITIES**

Business entities organized under state law include corporations, partnerships and limited liability companies. This chapter focuses on state law corporations and state law limited liability companies (LLCs) that have a single member, reserving discussion of partnerships and multiple-member LLCs to the Handbook chapter on Joint Ventures. This chapter also discusses a special election available to entities that qualify as corporations under federal tax law called the "S election." It should be noted at the outset that a governmental entity, such as an Indian tribe, is not a qualified "S corporation" shareholder.

#### **A. State Law Corporations**

State-law corporations are relatively easy to organize and offer certain advantages. Virtually every state has a statute that permits persons to organize a corporation for business or nonprofit purposes. Distinguishing characteristics of the corporate form of doing business include limited liability for the owners of the corporation, centralized management, transferability of ownership interests (generally in the form of shares of stock), and continuity of life. Since 1994, the IRS has taken the position that a State law corporation, even if wholly owned by a federally recognized tribe, does not share the same federal tax status as the tribe. Because of this unfavorable treatment, many tribes avoid forming state-law corporations--even though they are easily organized and widely recognized by potential business partners and lenders. A state law corporation is also more likely to be viewed as separate from the tribe, and thus not as an entity that shares in the tribe's sovereign immunity from suit.

##### 1. Brief Description

###### *a) Powers of business corporation defined by charter and state law*

The powers of a business corporation are generally defined by its charter (or articles of incorporation) as limited by state law. Typical powers for state law corporations include the powers to do the following:

- Sue and be sued, complain and defend in the corporation's own name
- Purchase, receive, lease, own, hold, improve and otherwise deal in or with real or personal property
- Sell, convey, mortgage, pledge, exchange or otherwise dispose of property
- Lend money
- Acquire interest in another enterprise or entity

- Enter into contract and guarantees
- Incur liabilities, including through the borrowing of money or issuing of bonds
- Transact any lawful business.

b) *Separate legal entity*

The essence of a corporation is that it is a legal entity from its owners. Courts are generally reticent to "pierce the corporate veil" (i.e., to disregard the legal separateness of a corporation vis-à-vis its owners) unless certain factors are present. Some of the key steps that can be taken to avoid veil piercing include:

- Adequate capitalization
- Compliance with legal requirements for issuance of stock
- Maintenance of corporate records
- Maintenance of separate financial records and bank accounts
- Avoidance of inter-corporate loans
- No guarantees by tribe of subsidiary's debt
- No assignment of contracts between tribe and subsidiary
- No representation the entity's primary purpose is to limit liabilities
- Maintenance of adequate insurance
- No interlocking or identical boards.

These same key steps should also be taken to protect the separate status of other limited liability entities, whether such entities are formed under state law or tribal law. *See Appendix B, Key Steps to Protect the Corporate Veil and Limit Liability.*

c) *Power to sue and be sued*

In virtually all states, corporations have the power to sue and be sued. How this power is interpreted varies from state to state. State law (including judicial interpretations of this power) should be reviewed to determine whether or not it is consistent with corporation's claim to tribal sovereign immunity where the corporation is wholly owned by the tribe.

2. Organizational Requirements

The organizational characteristics and requirements for a state law corporation will vary according to the applicable law of the state under which it is formed. Most states have very detailed corporate codes--in most cases, with separate provisions for stock and nonstock (i.e., not-for-profit) corporations. There are some common characteristics and procedures for forming and managing corporations.

To form a corporation, the incorporators must generally select a name and draft articles of incorporation. Most states' corporate codes require the following items to be included in the articles of incorporation of any type of corporation:

- The name of the corporation
- The term or period of existence of the corporation (which may be perpetual)
- The purpose(s) for which the corporation is organized (with an eye to consistency with lawful corporate purposes under the state's corporation code or statute);
- Procedures relevant to the governance of the corporation, including the election of directors and rights of shareholders;
- The address of the corporation's initial registered office and the name of its initial registered agent at such address;
- The number of persons constituting the initial board of directors and the names and addresses of the persons who are to serve as directors;
- The name and address of each incorporator;
- Provisions regarding the issuance and classes of stock by the corporation;
- Provisions relating to the payment of dividends; and
- Liquidation and dissolution procedures.

After filing articles of corporation with the state, a newly formed corporation will generally have an organizational meeting to elect its officers and directors, adopt its bylaws, set up its bank account, adopt a fiscal year, and establish a corporate records book to hold its key documents, including the minutes of every board meeting.

### 3. Relationship to Tribal Government

A state law corporation may be wholly owned and controlled by a tribal government, or it may be owned in part by the tribe and in part by other entities or individuals. A state law corporation will be regulated by the state for corporate law purposes (e.g., compliance with the state's corporate code, fiduciary duty rules, shareholder rights issues).

By incorporating under state law, a tribe does not subject the corporation to state regulation for all purposes--particularly with respect to its on-reservation operations. However, a state law corporation going beyond reservation boundaries will be more likely to find itself subject to state regulation than an unincorporated division of the tribe.

### 4. Sovereign Immunity and Other Liability Issues

State law corporations are unlikely to be able to assert the organizing tribe's sovereign immunity. While state chartered corporations do not appear to be absolutely precluded from sharing in the tribe's sovereign immunity under appropriate circumstances, it is likely that the corporation asserting immunity would need to be primarily, if not exclusively, involved in on-reservation governmental projects. In such situations, under the law of certain jurisdictions, a tribally-owned state chartered corporation might be viewed as an arm of or alter ego of a tribe. But, it appears that as more courts face the issue, organization under state law may be fatal to a finding of entity-level sovereign immunity, particularly for corporations that are structured to limit shareholder liability.<sup>72</sup>

The factors relevant to a sovereign immunity analysis of a state law corporation are similar, if not identical to those pertaining to such an analysis of tribal corporation. These factors include:

- Whether the tribe as owner or sole shareholder of the corporation is financially liable for the corporation's legal obligations;
- Whether the corporation's purpose is governmental or commercial;
- The extent and nature of the tribe's control over the corporation; and
- Whether federal policies would be furthered by finding that the corporation shares the tribe's immunity.

*See Appendix A, Sovereign Immunity Factors in Recent Judicial Decisions.*

One court has found that a tribal corporation organized under the District of Columbia Nonprofit Corporation Act could exercise the tribe's sovereign immunity based on the court's analysis of the above factors and their application to the unique facts of the case.

- The corporation's purpose was governmental in nature--i.e., to provide housing and health and welfare services to tribal members.
- The corporation's governing body was comprised mainly of tribal officials, and thus the tribe controlled the entity.
- The tribe's funds were vulnerable to suits against the corporation.

Given the close connection between the entity and the tribe, the court found sovereign immunity was appropriate, even though the entity was incorporated by the tribe under state law.<sup>73</sup>

Some courts distinguish between entities organized by the tribe in the first instance and those purchased by the tribe subsequent to their incorporation. A Wisconsin court held that a tribe's purchase of a corporation's stock does not normally confer tribal immunity on the corporation.<sup>74</sup> In that case, even one hundred percent tribal ownership did not serve to extend the tribe's immunity to the acquired state-chartered corporation.



In sum, incorporation under state law lessens the chances that a court will treat the tribally-owned business entity as a sovereign "arm of the tribe." While the multi-factor test approach of current law does not preclude treating a state-chartered corporation like a tribal instrumentality with respect to sovereign immunity, the trend cuts against extending immunity to state-incorporated entities. In most cases, organization under tribal law provides a more flexible framework if the tribe wishes to extend its sovereign immunity to a wholly-owned corporation.

## 5. Tax Considerations

Since 1994, the IRS has taken the position that a state-chartered corporation, even one that is wholly owned by an Indian tribal government and engaged in exclusively on-reservation activities, does not share the same tax status of the tribe. Revenue Ruling 94-16 represents a significant reversal of a position that the IRS had taken in a series of private letter rulings in the late 1980s. Those rulings held that state law corporations wholly owned by an Indian tribe were not subject to tax if their business activities were conducted on the tribe's reservation. However, Revenue Ruling 94-16 determined that "a corporation organized by an Indian tribe under state law is not the same as an Indian tribal corporation organized under Section 17 of the IRS and does not share the same tax status as the Indian tribe for federal income tax purposes." Citing the Supreme Court's decision in *Moline Properties v. Commissioner*,<sup>75</sup> Revenue Ruling 94-16 states that "[g]enerally, the choice of corporate form will not be ignored."<sup>76</sup> Thus, unless there is some other basis for the corporation's exemption from federal income tax (such as an IRS determination that it qualifies as a Section 501(c)(3) organization), a state-law corporation is subject to tax and required to file annual corporate income tax returns (IRS Form 1120).

One unresolved issue is whether a tribally owned state-law corporation is subject to tax on all of its income or only on income derived from its business activities. Corporations are generally taxable not only on their business income, but also on income from investments and other sources. Revenue Ruling 94-16 states that a state-chartered corporation owned by an Indian tribe "is a taxable entity and is subject to federal income tax on all income earned from its business activities." It does not address the tax treatment of such a corporation's investment or other income.

When Revenue Ruling 94-16 was promulgated in early 1994, the IRS provided a period of several months before its new position on the taxability of state law corporations went into effect. This was intended to allow tribes to convert existing state law corporations into some other type of business entity that was not subject to corporate income tax.

As a general rule, a state law corporation that the tribe has formed or acquired cannot be "converted" to another form of entity without significant tax consequences. Section 337(d) and related IRS regulations provide for the imposition of tax on the "built-in gain" of a taxable corporation that converts to a tax-exempt corporation. *See generally Treas. Reg. § 1.337(d)-4.*

When tribes are in the process of acquiring an existing business in corporate form, they often find that shareholders would prefer to sell them the stock of their corporation, rather than dissolve the business and sell the assets to the tribe. Tribes need to be aware in such situations that they may be assuming various types of liabilities, including federal tax liabilities. Because of the "liquidation tax" on the built-in gain of a corporation, tribes should avoid buying the stock of a corporation to ease the sellers' tax burden unless they are prepared to undertake a process of due diligence to accurately quantify any past or prospective tax liabilities thereby assumed.

## 6. Financing Considerations

A state-chartered corporation wholly owned by an Indian tribe will not qualify as an issuer of tax-exempt bonds. In a 1998 private letter ruling, the IRS addressed the issue of whether a nonprofit state-law corporation formed by a tribe to provide various health care services could issue tax-exempt bonds to finance additions to its health center, including an emergency medical services building and a nursing home, all of which were located on the Tribe's reservation. Citing Revenue Ruling 94-16, the IRS suggested that where a tribe incorporates an entity is under the laws of a state, such an entity is not an integral part of the tribe. Thus, such an entity would not meet the requirement of Section 7871(c), which permits only an Indian tribal government or a subdivision thereof to issue tax-exempt bonds.<sup>77</sup>

An additional question in the tax-exempt financing area is whether a tribe's state-chartered corporation could be the recipient of tax-exempt financing as a borrower. If such a corporation is wholly-owned and the facilities to be financed constitute essential governmental functions, it would appear that a tribe could issue bonds on a tax-exempt basis and re-lend the proceeds to a state-chartered corporation, particularly one that is wholly owned by the tribe. However, the issue has not been definitively addressed in any IRS guidance issued to date.

Other forms of financing discussed elsewhere in this Handbook may be available for state-law corporations and LLCs that are wholly-owned by an Indian tribe. Such other options include:

- Government-guaranteed loans
- SBA loans
- Taxable bonds
- Private debt placements
- Commercial bank financing.

### **B. Subchapter S Corporations**

Subchapter S of the Internal Revenue Code treats an "S corporation" as a pass-through entity similar to a partnership. An S corporation must pass through income and

loss items separately to its shareholders and thus, as a general rule, the corporation is not subject to a corporate level tax on those items. Subchapter S is only applicable to a "small business corporation," defined as a domestic corporation that does not have more than 75 shareholders.

S corporations are not viable options for tribal ownership. Section 1361 of the Code restricts S corporation ownership to individuals, estates, certain types of trusts, entities described in Section 401(a) (pension plans) and Section 501(c)(3) (charitable organizations). Governmental entities are not listed as qualified S corporation shareholders. Moreover, a recent IRS revenue ruling specifically addresses the question of tribal government ownership of S Corporations, and concludes that tribal governments are not qualified S Corporation shareholders under current tax law.<sup>78</sup>

### C. State-Law Limited Liability Companies

An increasingly popular choice of business entity is the limited liability company ("LLC"). An LLC has the advantage of limited liability like a corporation. However, it is generally taxed like a partnership or other "flow-through" entity. If wholly-owned (i.e., an LLC with a single member), the LLC may be disregarded as a separate entity for tax purposes. However, a state-chartered LLC--even one that is wholly-owned by a tribe--would likely be treated as a separate legal entity for purposes of legal liability purposes. Thus, it might be difficult (but not impossible) for such an entity to assert tribal sovereign immunity

#### 1. General Description of Limited Liability Companies

The LLC is a type of organization that provides its owners with limited liability just like a corporation, but LLCs are not subject to double taxation like corporations are.<sup>79</sup> LLCs have become the preferred investment vehicle for investors who want to participate in the management of the entity's business and still limit their personal liability. Under the LLC structure, all of the members obtain the tax advantages of a pass-through entity, but unlike the limited partnership structure, members can limit their personal liability regardless of whether or not they participate in the management of the LLC's business. Thus, a closely held business that is structured as LLC is generally able to benefit from certain corporate advantages without jeopardizing its favorable tax.<sup>80</sup>

#### 2. Organizational Requirements

An LLC can be quickly and easily organized under the laws of most states. All that is required is that the organizers select a name and file a document similar to a corporation's Articles of Incorporation. In the case of an LLC, this document is generally referred to as the LLC's Articles of Organization. The key issues required to be addressed in the Articles of Organization are:

- Name of the organization

- Street address of the registered office of the LLC and the name of the registered agent at that office
- Brief description of the type of management structure of the LLC
- Name and address of each person organizing the LLC
- A statement that the LLC is organized under the LLC act or Code.

All other details about how the LLC is organized, managed, and owned can be reserved to the Operating Agreement, which does not need be filed with the State or made public.

Most LLCs supplement their Articles of Organization with a fairly detailed Operating Agreement, that spells out how they will be managed. From a management perspective, LLCs fall into one of two types: (1) member-managed; and (2) manager-managed. A "member-managed" LLC is subject to more control by its legal owners than a "manager-managed" LLC.

### 3. Liability and Sovereign Immunity

A chief characteristic of any state-law LLC is its ability to limit liability to the assets of the company, thereby protecting the LLC's owners or members from any personal or individual liability for the company's debts. State LLC statutes typically provide that the debts, obligations, and liabilities of an LLC will be solely those of the LLC, and no member or manager of the LLC will be personally obligated for such liability.<sup>81</sup> At the same time, such statute laws generally permit LLC managers or members to agree to assume personal liability for any debts of the entity.<sup>82</sup>

It is highly unlikely that state or federal courts would recognize a state-law LLC formed to engage in business as sharing in the sovereign immunity of a tribal government--even if the LLC's sole member is an Indian tribal government. One major hurdle is the fact that state law shields the owner of an LLC from its liabilities, but clearly contemplates that the LLC itself can be sued.

While no reported cases have explicitly held that formation of a state-law LLC eliminates tribal immunity for the LLC, at least two cases have suggested that such is the case. First, a Connecticut state court in an unreported opinion<sup>83</sup> stated that taking ownership of an off-reservation hotel in LLC form removed any immunity with respect to the LLC's conduct of hotel operations.<sup>84</sup> The Mashantucket Pequot Tribal Nation took ownership of the hotel through a newly-formed LLC of which it was the sole shareholder. Members of the hotel management team sued the LLC on various tort claims. The tribe did not assert sovereign immunity as a defense, and the jury returned a multi-million dollar verdict against the LLC.

Second, a California case contains language implying that a tribe, as sole shareholder of the LLC, might be liable under common law "alter ego" liability.<sup>85</sup> The case involved breach of contract claims against an LLC of which the tribe was originally

a 51% owner (and then later, a 100% owner). The plaintiff alleged that the LLC was an alter ego of the tribe and the court allowed discovery on the alter ego and sovereign immunity issues to proceed. In doing so, the court refused to accept the tribe's sovereign immunity as a basis for precluding litigation of the controversy.

*Comment: Tribal law LLC codes are frequently more flexible in this regard. For example, the Ho-Chunk Nation's LLC Code states that "if the Nation is the sole member of a LLC formed under this Act, that LLC shall possess the Nation's sovereign immunity from suit except to the extent otherwise provided in its Articles of Operation."*

#### 4. Tax Considerations

The federal tax treatment of LLCs is provided for under sections 301.7701-1 through 301.7701-3 of Treasury Regulations governing the federal tax classification of business entities (sometimes referred to as the "check-the-box" regulations). The check-the-box regulations allow certain entities to choose classification as either a partnership or a corporation, or to be treated as a disregarded entity for federal tax purposes. The check-the-box regulations also provide default classifications for certain business entities. Elections (on IRS Form 8832) are necessary only when an entity chooses initially to be classified as other than the default classification or when an entity chooses to change its classification.

Under the IRS check-the-box regulations, an LLC with a single owner is generally treated as a disregarded entity. As such, it is treated in the same manner as a branch or division of the owner. An LLC with two or more owners is generally treated like a partnership for tax purposes.

IRS regulations set forth a number of entities that are per se classified as corporations for federal income tax purposes. This list includes entities referred to as "incorporated" or as a "corporation," "body corporate," or "body politic" under a federal, state or tribal law or statute. This list of per se corporations does not include domestic limited liability companies (LLCs)--other than LLCs wholly owned by a state or foreign government. *See Treas. Reg. §301.7701-2(b)(6).*

The check-the-box regulations treat LLCs that are wholly owned by a state or foreign government as per se corporations. At the same time, they fail to specify how a tribal government-owned LLC will be treated.

*Comment: In the absence of a rule deeming tribal LLCs to be corporations, most advisers believe that tribal government-owned LLCs should be treated as a division of the tribal government for tax purposes. The IRS has specifically ruled that an LLC with a tax-exempt organization as its single member should be disregarded as a separate legal entity and treated as a division of the single member.*

**D. Advantages and Disadvantages of State-Law Business Entities**

The primary advantages of using a state-law business entity includes the following:

- State-law corporations and LLCs are easily and quickly organized
- State-law entities are familiar to lenders and potential business partners
- State-law entities can be effectively used to acquire or merge with an existing state-law entity.

In addition, state-law LLC are disregarded for federal income tax purposes when owned by a single member, such as a tribe.

Disadvantages include the following:

- State-law corporations are subject to federal income tax
- State-law entities are not qualified issuer in a tax-exempt financing
- State-law entities are not likely to be regarded as government instrumentalities that are immune from unconsented suit.

For off-reservation ventures, state-law LLCs still have a number of advantages and, from a tax perspective, very few disadvantages.

## V.

### **JOINT VENTURE ENTITIES**

There are several different types of entities that can be utilized for purposes of establishing a joint venture between an Indian tribe and a business partner other than the tribe:

- A Limited Liability Company ("LLC")
- A General Partnership ("GP") or a Limited Partnership ("LP")
- A Corporation.

In each case, the equity interests in the joint venture entity will most likely be owned in part by the tribe and in part by another party.

Each of these entities has certain advantages and disadvantages. However, in this chapter of the Handbook, we will focus the discussion on the two entity types that are the most advantageous for tribes to utilize--LLCs and LPs.

Although there may be occasions in which the parties to a joint venture prefer or are required to operate in corporate form, the tax consequences to an Indian tribe of operating a joint venture through a corporation are generally not as favorable as operating the joint venture through a non-taxable or flow-through entity. A corporation that is not wholly owned by a tribe is subject to corporate income tax on all of its income. Moreover, the corporation's taxable owners may also be subject to a second level of tax when they receive distributions from the corporation in the form of dividends. The two levels of tax on the income of a corporation can be reduced if the corporation's income is decreased by deductible fees paid to the equity owners for services rendered. Nevertheless, because LLCs and partnerships are generally more favorable to use for joint ventures than corporations, this chapter does not discuss in detail the use of corporations for joint ventures, but instead focuses on the use of LLCs and partnerships. Although there is one type of corporation, an S corporation, which is taxed as a flow-through entity, because tribes are not eligible shareholders of an S corporation, this chapter also does not discuss S corporations.

When a tribe forms an LLC or a partnership to engage in a joint venture with another party, tax considerations are not the only considerations. It is important at the outset to make sure that each party's role in the venture is appropriately spelled out in the organizational documents. Care should be taken that the terms of the transaction fairly compensate each party for what it brings to the table. Another key consideration is the inclusion of terms to accommodate a desire on the part of either party to terminate its participation in the venture.

## A. Limited Liability Companies

### 1. Brief Description and Examples

The LLC is a type of organization that provides its owners with limited personal liability just like a corporation, but it is not subject to double taxation as regular corporations are.<sup>86</sup> The LLC has become the preferred investment vehicle for investors who want to participate in the management of the entity's business and still limit their personal liability. Under the LLC structure, all of the members obtain the tax advantages of a pass-through entity, but unlike the partnership structure, members can limit their personal liability regardless of whether or not they participate in the management of the LLC's business. Thus, a closely held business that is structured as an LLC is generally able to benefit from certain corporate advantages without jeopardizing its treatment as a partnership for federal income tax purposes.<sup>87</sup>

As noted above, an LLC is a business entity in which limited personal liability may be achieved for the owners--similar to a corporation--while achieving flow-through taxation that is characteristic of a partnership. In addition, unlike a partnership, an LLC may be formed with a single member or owner, as well as by multiple members. The flexibility of the LLC as a business entity is what has led to its increasing popularity--particularly in the situation where the business starts out with a single owner, but intends to admit additional owners or partners at a later stage.

Tribes are beginning to use LLCs to partner with non-tribal business entities for a variety of purposes:

- To acquire specialized knowledge in fields such as energy or government contracts
- To create the proper incentives for those playing a critical role in a tribally-owned business
- To be able to efficiently allocate certain tax benefits (e.g., low income housing tax credits).

In addition to using LLCs to partner with non-Indian individuals or businesses, tribes are also using LLCs to partner with other tribes. Four Fires, LLC, a economic development entity organized by the Oneida Tribe of Indians of Wisconsin, San Manuel Band of Mission Indians, the Forest County Potawatomi Community of Wisconsin and Viejas Band of Kumeyaay Indians, is a good example of an inter-tribal LLC. It owns a hotel near the United States Capitol building in Washington, D.C.

### 2. Organizational Requirements

An LLC can be quickly and easily organized under the laws of most states. All that is required is that the organizers select a name and file a document similar to a corporation's Articles of Incorporation. In the case of an LLC, this document is generally



referred to as the LLC's Articles of Organization (although Delaware, perhaps the most popular state for forming LLCs, refers to them as a Certificate of Formation). The key issues required to be addressed in the Articles of Organization are:

- Name of the LLC
- Street address of the registered office of the LLC in the state where the LLC is being formed and the name of the registered agent at that office
- Description of the purpose for which the LLC is being formed
- Description of the type of management structure of the LLC (e.g., whether the LLC will be managed by its members or by a manager or managing member)
- Name and address of each person organizing the LLC
- A statement that the LLC is organized under the LLC Act or Code of the state where the LLC is being formed.

All other details about how the LLC is organized, managed, and owned can be reserved to the Operating Agreement, which need not be filed with the State or made public.

Most LLCs supplement their Articles of Organization with a fairly detailed Operating Agreement, that spells out how they will be managed. From a management perspective, LLCs fall into one of two types: (1) member-managed; and (2) manager-managed. A member-managed LLC is subject to more control by its legal owners than a manager-managed LLC.

The key features of an LLC Operating Agreement are provisions addressing the following:

- Identity and Classes of Members
- Members' Duties and Obligations
- Management of the LLC
- Contributed Capital and Capital Accounts
- Allocations and Distributions
- Liability and Indemnification
- Withdrawal of Members
- Arbitration and Dispute Resolution.

**B. General Partnerships and Limited Partnerships**

1. Brief Description

There are two types of partnerships--general partnerships ("GPs") and limited partnerships ("LPs"). The differences are discussed below.

*a) General Partnerships*

In a GP, each partner of the GP assumes general personal liability for the activities of the partnership. A GP is easily organized, but is not frequently utilized unless the joint venture partners are incorporated or have some form of liability protection.

*b) Limited Partnerships*

An LP is a partnership with one or more limited partners and at least one general partner. The most popular feature of the LP is the limited liability of the limited partners. The limited partners are protected against personal liability for debts of the partnership that exceed their equity or capital contribution to the partnership. However, in order to retain this limited liability, the limited partners may not participate in the management or control of the partnership's business. Unlike the limited partners of an LP, the general partners of an LP assume general personal liability for the activities of the partnership.

2. Organizational Requirements

The core document for a partnership is a Partnership Agreement. The key features of a Partnership Agreement are substantially the same as with respect to the Operating Agreement of an LLC and are as follows:

- Identity and Classes of Partners
- Partners' Duties and Obligations
- Management of the Partnership
- Contributed Capital and Capital Accounts
- Allocations and Distributions
- Liability and Indemnification
- Withdrawal of Partners
- Arbitration and Dispute Resolution.

An LP, unlike a GP with no limited partners, must file an executed certificate of limited partnership with state in which the entity is organized.

**C. Considerations Common to LLCs and LPs**

1. Relationship to Tribal Government

In forming an LLC or LP that is designed to serve as a joint venture with a third party, the tribe should consider whether it would like to own the LLC directly or through

an intermediary business entity. Because of the tribe's sovereign immunity and other uncertainties, some potential business partners prefer that the tribe hold its interest through an entity that is legally separate from the tribe. Possible options for the tribe include holding the LLC interest through (1) a single-member LLC, (2) a Section 17 or Section 3 corporation, (3) a tribally chartered corporation, or (4) an economic development authority that qualifies as a political subdivision. Because of the unfavorable tax treatment, holding a joint venture interest through a state-law corporation is not recommended.

## 2. Sovereign Immunity and Other Liability Issues

Many of the sovereign immunity and liability issues surrounding tribally owned LLCs and partnerships remain unresolved. Because of the dearth of decided cases, it is unclear whether the sovereign immunity claims of tribal LLCs or LPs will be analyzed similarly to those asserted by tribal corporations or whether a different method of analysis will be used. It is also unclear whether ownership of less than 100% of the entity will be fatal to assertions of immunity from suit. No court has ever held that a business entity that was less than wholly-owned by a tribe can exercise the tribe's immunity. Given this situation, it is safest to assume that the formation of an entity that includes individuals or entities other than the tribe will likely eliminate the connection required to establish that the entity shares the tribe's sovereign immunity.

The only case to discuss the sovereign immunity implications of a partially owned LLC did not decide whether the LLC shared the tribe's immunity.<sup>88</sup> The opinion appears to assume that the LLC, which was 51% owned by the tribe initially and later 100% owned by the tribe, did not enjoy sovereign immunity.<sup>89</sup> However, the contract between the parties anticipated the possibility that a court could hold that the LLC was a "tribally controlled entity" and therefore that it could exercise immunity.<sup>90</sup> The court did not resolve the issue and it is uncertain whether an argument in favor of sovereign immunity would have succeeded.

It is possible that an LLC partially wholly owned by a tribe would be analyzed under the multi-factor test applied to tribal corporations. The applicable factors include: (1) whether the tribe will be financially liable for the corporation's legal obligations; (2) whether the corporation's purpose is governmental or commercial; (3) the extent and nature of the tribe's control over the corporation; and (4) whether federal policies would be furthered by finding that the corporation shares the tribe's immunity.<sup>91</sup>

The third factor (extent and nature of tribe's control) would appear to preclude a finding of immunity for any entity that is not controlled by a tribe. If a tribe held more than 50 percent of the ownership interests, it would at least have an argument in favor of a finding of sovereign immunity, but less than majority ownership would seem to eliminate the necessary level of tribal control over the entity.<sup>92</sup>

## 3. Tax Considerations Applicable to LLCs and LPs

In general, an entity that is a partnership (or an LLC that is taxed like a partnership) is not subject to federal income tax. Rather, each partner (or member in the case of an LLC) includes in its income such partner's allocable share of income, deductions, gains, losses, and credits generated by the partnership. LLCs and LPs combine the tax advantages of a "flow-through" or "pass-through" entity with limited personal liability. An LP is considered a pass-through entity because the partnership itself does not pay tax,<sup>93</sup> but, partnership income is allocated and taxed to the partners, whether or not they receive a distribution of all or any part of such income. Furthermore, the partners may use the losses or credits generated by the partnership to offset their income from other sources (subject to certain limitations that are beyond the scope of this manual).

With respect to tribal participation in a partnership, the IRS has stated that a tribe that is a partner in a partnership is not subject to federal income tax.<sup>94</sup> The IRS has cautioned, however, that "a tribally owned state chartered corporation that is a partner [in a partnership] will be subject to federal income tax on its distributive share of partnership income."<sup>95</sup>

Sections 301.7701-1 through 301.7701-3 of the Treasury Regulations (the "check-the-box" regulations) govern the federal tax classification of business entities. The check-the-box regulations allow certain joint ventures to choose classification as either a partnership or a corporation. The check-the-box regulations provide default classifications for business entities.<sup>96</sup> Elections (on IRS Form 8832) are necessary only when an entity chooses initially to be classified as other than the default classification or when an entity chooses to change its classification.<sup>97</sup>

The check-the-box regulations provide, in relevant part, that a "business entity" is any entity recognized for federal tax purposes that is not properly classified as a trust. A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership.

The regulations set forth a number of entities that are *per se* classified as corporations for federal income tax purposes. This list includes entities referred to as "incorporated" or as a "corporation," "body corporate," or "body politic" under a federal or state statute, or the laws of a federally recognized Indian tribe. This list does not include domestic limited liability companies (other than those wholly owned by a state or foreign government.)<sup>98</sup> Thus, under the check-the-box regulations, an LLC or LP that has two or more members (one of which is a tribe) will be treated like a partnership for tax purposes unless it specifically elects to be treated like a corporation.

The following federal income tax rules apply to both partnerships (such as LPs) and LLCs:

- Generally, the contribution of "property" to a partnership in exchange for a partnership interest is a nontaxable event for the partnership and the contributing partner.

- A partner may also contribute "services" to the partnership in exchange for a partnership interest.
  - Generally, a partner who receives a partnership capital interest in exchange for performance of past, present or future services for the partnership will realize ordinary income.<sup>99</sup>
  - Where a partner receives a profits interest in the partnership in exchange for services, the exchange generally will not be treated as generating taxable income.<sup>100</sup>
- Partnership losses, income, gains, or credits flow through to the partners.
- The character of such income, loss or credit to a partner will be the same as if the distribution bypassed the partnership and was made directly to the partner.
- Because partners are taxed on the income of the partnership whether or not they receive a distribution of all or any part of such income, when a partner actually receives a current distribution from a partnership, as a general rule, neither the partner nor the partnership will recognize gain or loss on the transaction unless the distribution exceeds the partner's basis in its partnership interest, in which event, gain is recognized.

Partnerships and LLCs also have the flexibility to shift economic and tax attributes among the owners, subject to the following restrictions:

- The partners' distributive shares of income, gain loss, deduction or credit are generally determined under the partnership agreement.<sup>101</sup>
- The allocations of partnership income, gains, losses or credits provided in the agreement must either have "substantial economic effect" or be in accordance with the partners' interest in the partnership.

Although an Indian tribe is not subject to federal income tax, not all of the federal tax rules applicable to other organizations exempt from federal income tax under the Internal Revenue Code (the "Code") are applicable to a tribe or to an entity that shares the same tax status as an Indian tribe.

- First, unlike charitable organizations described in Section 501(c)(3) of the Code, an Indian tribe generally is not subject to federal income tax on "unrelated business taxable income" ("UBTI") under Sections 511-514 of the Code.<sup>102</sup> Therefore, an Indian tribe does not need to be concerned about issues related to UBTI in the joint venture context.
- Second, unlike charitable organizations described in Section 501(c)(3) of the Code, an Indian tribe is not subject to the requirements that it operate exclusively for charitable purposes and not for private benefit. Thus, an Indian tribe will not jeopardize its tax-exempt status if it does not "control" a joint venture.

However, Congress has recently stiffened rules aimed at preventing tax-exempt entities (including tribes) from shifting inappropriate tax benefits to taxable parties. Thus, consultation with experienced tax counsel is strongly recommended.

*Note that the discussion in this chapter focuses on federal income tax matters only. LLCs, partnerships and other flow-through entities may be subject to tax in certain states that do not recognize the non-taxable nature of flow-through entities.*

#### 4. Financing Considerations

It is unlikely that a public-private joint venture would qualify to utilize the proceeds from a tax-exempt bond offering because of the absolute prohibition on the issuance of so-called "private activity" bonds by an Indian tribal government and the Tax Code's strictly interpreted "essential governmental function" test. However, there are many other types of financing available, including the following:

- Government-guaranteed loans (Department of the Interior's IEED and SBA)
- Taxable bond issuances
- Private placements
- Commercial bank financing.

Under the IEED Loan Guaranty, Insurance, and Interest Subsidy Program, only a joint venture in which a federally recognized tribe holds a majority interest is eligible for such financing.

The Small Business Administration also has loan programs available to assist small business ventures. Such ventures may be co-owned by a tribe and another party provided that they otherwise meet SBA loan requirement. For example, SBA loans are available only to applicants for whom credit is not otherwise available on reasonable terms.

*These financing options are discussed in detail in Chapter II.A.5.*

#### 5. Advantages and Disadvantages

Advantages of conducting economic development and business activities through a jointly-owned LLC or LP include the following:

- Ease of formation
- Flexibility (relative ability to design own governance structure)
- Flow-through taxation resulting in tribe's share of joint venture income flowing through free of federal tax to the tribe.

Disadvantages of conducting such activities through a jointly owned LLC or LP include the following:

- Likely loss of sovereign immunity for the joint venture entity
- Inability to qualify for certain types of financing
- Difficulties in unwinding the venture if one party wants to terminate.





## VI.

### EVALUATING YOUR OPTIONS

#### A. Comparison of Each Form

As you have learned there are many possible business structures for tribal governments to evaluate when considering how to organize for economic development. As discussed in the previous chapters, your choice of business structure will have long-term consequences and will impact how tribal assets are protected, how tribal sovereignty is preserved, and how potential liability and tax liability can be minimized. When you evaluate possible structures, you need to take into account various factors about the business activity you are considering--the relative importance of each factor depends on the nature and the extent to which the tribe seeks to keep business decisions separate from tribal governmental decisions, and the degree of financial and legal liability to which it is willing to expose itself and tribal assets. You should devote the necessary time and energy to evaluate the best structure for the particular business you are considering. Below is a brief summary comparing the key factors that should be considered in choosing the best structure for your business.

##### 1. Organizational Requirements

You can choose to organize under federal, state, or tribal law. Your choice of law will have implications for how the entity will be treated for purposes of tribal sovereign immunity and for federal income tax purposes.

Some organizational structures are more formal than others and do not require a lot of lead time to establish. For example, a key attribute of a tribal unincorporated entity or a tribal instrumentality is that it is relatively easy to form and can be established by tribal resolution or ordinance. If you are looking for simplicity, this is the entity—what it lacks in bells and whistles is made up for in its ease of formation, maintenance and dissolution. Ease of formation means minimal paperwork and negligible start-up costs. The tribal government is the owner and is in charge of making decisions. The biggest potential drawback is that tribal government assets and liabilities are not separated from the entity's business obligations and liabilities.

Some entities take advance planning and time to form. A Section 17 corporation, like a Section 3 corporation, is a separate legal entity from the tribe. Section 17 and Section 3 corporations require carefully drafted organizational documents and navigation of the federal and tribal approval process. It takes quite a bit of lead time to obtain the required Secretary of the Interior approval and tribal ratification of a corporate charter. As separate legal entities, these corporations operate and are managed independently of a tribal government. The decisions are usually made by a board of directors separate from the tribal council.

Similarly, a tribal political subdivision takes some time and expense to form and then to obtain the necessary Bureau of Indian Affairs and Internal Revenue Service approvals. A political subdivision must be delegated one or more tribal governmental powers in order to be treated the same as the government itself for tax purposes.

Some entity forms give tribal governments a lot of flexibility in determining the management structure for an entity. For example, a tribe can determine the management structure of a tribal instrumentality, a political subdivision, or a tribal law corporation under its own law. In the case of other forms, such as a Section 17 corporation or a state law corporation, some requirements for organization and formation are determined under federal and state law, respectively.

A tribal law corporation, a state law corporation, or a tribal or state LLC--each require carefully drafted organizational documents and advance planning to form. However, the external approval process is generally much faster for these business entities than for political subdivisions or Section 17 corporations.

In addition, some organizational forms provide more protection for tribal government assets by segregating tribal business assets and liabilities from the tribal government. With these forms, the tribe itself is not liable for the debt and liabilities incurred by the corporation except to the extent it pledges assets or capital to the business entity. These include: a tribal corporation, a state law corporation, and a Section 17 corporation, as well as all types of LLCs.

## 2. Relationship to Tribal Government

The organizational form you chose will also dictate the relationship or degree of independence a business entity has from the tribal government. For certain business ventures, a tribe may want to create an entity that operates fairly autonomously from the tribal government and has the ability to attract the necessary technical and managerial expertise to run the day-to-day operations of the business. These can include: a tribal corporation, a state law corporation, and a Section 17 corporation.

If you want management to be more centralized with the tribal government, these forms should be considered: tribal instrumentality and unincorporated tribal entity.

Other types of business entities may involve the exercise of tribal governmental regulatory functions and may be more appropriately formed as instrumentalities or political subdivisions of a tribe. Examples include tribal utilities and telecommunications entities that provide services to an Indian reservation or provide other quasi-governmental services.

## 3. Sovereign Immunity and Other Liability Issues

Some business structures permit tribal governments to confer on the entity the tribe's sovereign immunity from suit and other governmental powers in its organizational

documents. These structures include: a tribal instrumentality or unincorporated business, a tribal political subdivision, a Section 17 corporation and Section 3 corporation.

The location of your business activities may also dictate what structure should be chosen. For example, for off-reservation business activities where sovereign immunity is a major concern for a tribal government, a federal Section 17 corporation may be the form that can best shield tribal assets. Additionally, an unincorporated tribal entity may also share the sovereign immunity of the tribe both for on and off-reservation activities. If a tribe incorporates under state law for off-reservation activities, it can be subject to suit based on the law under which it incorporates.

If a tribe wants to insulate tribal assets from debt obligations and liabilities of its business, it should consider forming a separate entity that can shield tribal assets through limited liability protection. This would include all forms of corporations--including a tribal law corporation, Section 17 corporation, Section 3 corporation, and a state law corporation.

As noted in the tribal corporation chapter, in certain situations, corporations organized under tribal law may share the organizing tribe's sovereign immunity from suit. Courts have developed various methods to determine whether a tribe is immune from suit.

Both state chartered corporations and LLCs would most likely be treated as separate legal entities from the tribe and thus would not likely be viewed as sharing the tribe's immunity from suit.

#### 4. Tax Considerations

The IRS has consistently ruled that federally-recognized tribes are not subject to federal income taxes because they are not considered taxable entities. Therefore, any income earned by a tribe is not subject to federal income tax regardless of whether the business activity is on or off Indian-owned lands.

The IRS has ruled that unincorporated tribal entities, Section 17 corporations, and Section 3 corporations organized under the OIWA, are not taxable entities for purposes of federal income tax regardless of whether the business activity is on or off-reservation. Additionally, IRS practice has been to treat tribal political subdivisions like the tribe itself for federal tax purposes.

Section 7871 of the Tax Code treats Indian tribal governments and their political subdivisions like state governments for specific tax purposes. The key benefits include: exemption from certain excise taxes levied on fuels, manufactured goods, communications and certain highway vehicles and authority to issue tax-exempt bonds for facilities that serve an "essential governmental purpose."

In contrast, a wholly-tribally owned state chartered corporation is likely to be considered a separate taxable entity by the IRS, even when operating exclusively on-reservation.

As noted earlier, the federal tax treatment of tribally-chartered corporations is uncertain at this time. The IRS and Treasury Department indicated in 2001 that they would issue guidance on this issue, but have not yet done so. In the interim, many tribal advisors have ceased forming new tribally-chartered corporations, and some tribes have converted their tribally-chartered corporations to other types of business entities pending the IRS guidance.

Also, the IRS has not yet made a final determination on how tribal LLCs incorporated under state or tribal law will be treated under its check-the-box regulations. Under the regulations as they currently stand, a single member LLC is generally treated as a disregarded entity. Under this general rule, the IRS would treat a tribal single member LLC as sharing the same tax status as the tribe. At the same time, IRS regulations treat state or foreign government single member LLCs as per se corporations, and therefore potentially taxable. However, it has not made a similar determination for tribal governments. In the absence of a change in the regulations or some other formal IRS guidance, tribal advisors believe that a single member LLC owned by a tribe should be treated as a division of tribal government for tax purposes. An LLC with two or more members is treated like a partnership and a tribe's share of income would generally flow through to the tribe free of tax.

## **B. Key Factors to Consider**

### **1. Timing**

If a short-time frame is required, the quickest and simplest entity to form is an unincorporated arm or instrumentality of the tribal government by tribal resolution or ordinance.

A tribal political subdivision maybe established under tribal law to carry out a substantial governmental or quasi-governmental function of the tribe, such as a business development, housing, or energy development. The formation of a political subdivision does require some lead time and expense to establish because of the required approvals by both the Bureau of Indian Affairs and the Internal Revenue Service.

Most corporations can be easily and quickly formed under the incorporation law under which they are established. A tribal law corporation would also require some lead time to draft a charter and incorporate under tribal law depending on the level of detail required under tribal incorporation law. The same is true for a state-chartered corporation or LLC.

Establishing a Section 17 or Section 3 corporation does require more advance planning and a substantial amount of time to get through the federal and tribal approval

process. A tribe must first draw up a petition and draft charter and submit it to the BIA for approval. BIA review and approval can take up to one-year. After the BIA approves the charter, it needs to be ratified by the tribal council. BIA is currently in the process of streamlining the procedures.

## 2. Requirements of Business Partners and Lenders

Business partners may insist on entity types with which they are more familiar or which offer more certainty. Many business partners may not be familiar with tribal laws or of their ability to enforce tribal agreements under tribal law or in tribal courts. For these reasons, they may require incorporation under state or federal law.

A tribe operating as an arm or instrumentality of the tribal government may have difficulty obtaining conventional financing. Lenders may be reluctant to provide credit if they are not certain they can enforce their agreement due to the sovereign immunity of the tribe.

Only a wholly-owned tribal entity that is not legally separate from the tribe can be an issuer or borrower in a tax-exempt financing. Such entities include: an unincorporated tribal instrumentality, a tribal political subdivision, as well as a Section 17 and Section 3 corporation. When a subdivision or federal law corporation, and not the tribe itself, is the issuer/borrower, overly invasive disclosure of tribal financial records can be avoided. Since it is not clear whether a tribally chartered corporation will be treated like an integral part of the tribe for federal income tax purposes, it is also unclear whether such an entity can issue tax-exempt bonds.<sup>103</sup>

To be eligible for the Department of the Interior's Office of Indian Energy and Economic Development (IEED) Investment Capital Program, including its loan guarantee and loan insurance programs, at least 51% of the entity must be owned by a federally-recognized tribe.

Also, certain entity types do not lend themselves to equity financing or to ownership by multiple owners. If you plan on forming a business with multiple owners, this may exclude certain entity types from consideration--tribal unincorporated entities, political subdivisions, and federally-chartered corporations must be wholly-owned by the tribe.

An LLC organized under state law is an attractive entity for multiple owners and can preserve the non-taxable status of the tribe for federal income tax purposes. If a tribe is a member of an LLC with multiple members, the LLC will be treated as a partnership for tax purposes. Since income is allocated to each partner, the IRS has ruled that a tribe in a partnership is not subject to federal income tax. However, the IRS has cautioned that a tribally-owned state-chartered corporation that is a partner in a partnership would be subject to federal income tax for its distributive share of partnership income. Similarly, a state-chartered tribal LLC will not qualify as an issuer of tax-exempt bonds.

An LLC organized under tribal law could also permit multiple owners and could arguably share in the non-taxable status of the tribe for federal income tax purposes.

### 3. Anticipated Profitability

If the business entity is not anticipated to generate a significant amount of profits, the federal tax liability of the entity may be less of a factor to consider in choosing the entity type. For example, in the Qualco Case Study, the Tulalip tribes formed an energy power generation company which was driven by the off-reservation environmental interests of the tribes. The entity was established to promote and preserve the off-reservation fish habitat of the tribes and to promote long-term working relationships with local farmers--all profits generated by the entity are dedicated to habitat restoration. For these reasons, and to give certainty to their non-Indian business partners, the Tribe incorporated as a non-profit corporation under state law.

On the other hand, if you anticipate that the entity will generate substantial profits from either on or off-reservation activities, an unincorporated tribal entity or a Section 17 or Section 3 corporation may be your best entity option since the IRS has made a clear determination that these are not taxable entities for purposes of federal income tax.

For business activities exclusively on the reservation, a political subdivision of the tribal government may also be attractive if the business activity is quasi-governmental in nature.

As mentioned above, there is some uncertainty as to whether tribally-chartered corporations or single member LLCs will share the same tax status of the tribe.

TYPE OF ENTITY	LAW GOVERNING FORMATION	SOVEREIGN IMMUNITY	LEGAL LIABILITY	FEDERAL TAX TREATMENT	FINANCING
<b>Tribal Instrumentality and unincorporated entity</b>	Tribal law, constitution, code, resolution or ordinance	Can share the same attributes of immunity as tribal government; immunity can be waived by tribe; waiver must be in accordance with tribal law	Tribal assets may not be segregated from entity; Tribal government may be liable for debts and obligations of tribal enterprise	Not subject to federal income tax (regardless of location of business activities) if the entity is not separate from the tribe.	Equity financing not possible; may qualify for tax-exempt financing if IRS requirements met; may be eligible for government guaranteed loans
<b>Tribal Political Subdivision</b>	Created under Tribal law through a special purpose ordinance or resolution to exercise one or more sovereign powers delegated by the tribe	Shares same attributes of immunity as tribal government; immunity can be waived by tribe	Whether tribal government is liable for debts and obligations of its political subdivisions would be determined under tribal law.	IRS practice has been to treat political subdivisions the same as the tribe—so long as they qualify as such by having been delegated substantial governmental powers	Can be both borrower and issuer of tax-exempt financing for facilities or operations that meet the essential governmental functions test; may be eligible for government guaranteed loans; can issue clean renewable energy bonds (CREBS)

CHART: STRUCTURE AT A GLANCE

<b>TYPE OF ENTITY</b>	<b>LAW GOVERNING FORMATION</b>	<b>SOVEREIGN IMMUNITY</b>	<b>LEGAL LIABILITY</b>	<b>FEDERAL TAX TREATMENT</b>	<b>FINANCING</b>
<b>Tribally Chartered Corporation</b>	Tribal law, constitution, code, resolution or ordinance	A corporation that operates independent from the tribal government may not share the immunity of the tribe (multi factor test).	A wholly owned tribal corporation should make clear in its organizing documents that the tribal shareholder is not liable for debts of the corporation except to the extent of its contributed capital or the shares it owns.	Tax treatment is uncertain. In, 2001, the IRS and the Treasury Department agreed to resolve the uncertainty by issuing guidance but have not yet done so. For this reason, many tribal advisors have ceased creating new tribal law corporations.	It is not clear whether tribal law corporations can issue tax exempt bonds. Government guaranteed loans, taxable bond issuances, private placements, commercial bank financing available.
<b>Section 17 Corporation</b>	Federal charter issued under the Indian Reorganization Act	Corporate charter can confer the same privileges and immunity as tribe; waivers of sovereign immunity pursuant to the "sue and be sue clause" in the corporate charter should be limited to a waiver of only the corporation's sovereign immunity and such waiver should be restricted in scope to transactions of the corporation and limited to claims against the assets of the corporation and not the tribe itself	Assets and liabilities of the corporation are segregated from tribal government assets; Tribal government can pledge assets or property to the corporation; tribal government is not liable for debts or obligations of the corporation	Not subject to federal income tax regardless of location of business activities	Section 17 Corporation can pledge assets and property of the corporation; is eligible for government guaranteed loans; can issue tax exempt bonds for "essential governmental services" and can issue clean renewable energy bonds; joint ventures or equity partnerships possible through a LLC subsidiary chartered under a Section 17 corporation.

CHART: STRUCTURE AT A GLANCE



TYPE OF ENTITY	LAW GOVERNING FORMATION	SOVEREIGN IMMUNITY	LEGAL LIABILITY	FEDERAL TAX TREATMENT	FINANCING
<b>State Law Corporation</b>	Created under state law for-profit or nonprofit purposes	Need to look at state law to determine power to sue and sued	Assets and liabilities of the corporation are segregated from tribal government assets; Tribal government can pledge assets or property to the corporation; tribal government is not liable for debts or obligations of the corporation	IRS has taken position that a state chartered tribal corporation does not share the same tax status as the tribe and it therefore taxable.	Does not qualify as an issuer of tax-exempt bonds or clean renewable energy bonds.
<b>State Chartered Limited Liability Company</b>	Created under state law	A single member LLC owned by a tribe would likely be considered a separate legal entity for purpose of legal process and thus not likely to be viewed as sharing the tribe's immunity from suit.	Has advantage of limited liability like a corporation; Tribe is not liable for debts or liabilities of LLC.	Taxed like a partnership or other "flow through" entity. IRS has not ruled on treatment of tribal single member LLC, in the absence of a rule, tribal advisors believe that a tribal government owned-LLC should be treated as a division of tribal government of tax purposes.	Does not qualify as an issuer of tax-exempt bonds or clean renewable energy bonds.

CHART: STRUCTURE AT A GLANCE

## SOVEREIGN IMMUNITY FACTORS IN RECENT JUDICIAL DECISIONS

In determining whether a tribal enterprise or business entity shares the tribe's immunity from suit, courts typically consider a number of factors, including but not limited to the following:

- Whether a judgment against the tribal entity will reach the tribe's assets
- Whether the tribal entity has the power to bind the tribe's assets or to obligate tribal funds
- Whether the tribe and the tribal entity are closely linked through governance structure and other characteristics (e.g., tribal control over appointment and removal of entity board members, extent of board's power over the entity's operations)
- Whether federal Indian law policies intended to promote tribal self-determination would be furthered by extending immunity to the entity
- Whether the entity is organized for governmental or for "commercial" purposes
- Whether the entity holds title to property in its own name
- Whether the entity is legally separate and distinct from the tribe (e.g., as is normally the case with a separately incorporated entity).

In several jurisdictions, the main factors that determine whether a tribal enterprise or entity shares the parent tribe's sovereign immunity are (1) whether a judgment against the entity will reach the tribe's assets, and (2) whether the entity has the power to bind the tribe's assets or obligate the tribe's funds.<sup>104</sup> In some jurisdictions, if the answers are "no," the inquiry ends. Tribal entities that generate their own revenue and cannot bind or obligate tribal funds cannot lay claim to tribal sovereign immunity.<sup>105</sup> In others, these are just two factors to consider.<sup>106</sup>

Another key factor is whether the tribe and the tribal entity, such as an entity, are closely linked in governing structure and other characteristics. Courts typically analyze the corporation's board of directors, including its composition, how its members are chosen, and the tribe's control over the procedure for their removal.<sup>107</sup> If the corporation's board of directors is separate from the tribal government so that the board exercises full managerial control over the corporation, the corporation is more likely to be considered a separate and distinct entity that does not share the tribe's immunity. Also relevant is the level of control the tribe retains over appointing and removing board members. The less control the tribe has, the less likely a finding in favor of immunity.

Another factor typically analyzed is whether federal policies intended to promote Indian tribal autonomy are furthered by extending immunity to the entity. Examples of applicable federal policies include protecting tribal assets; protecting tribal cultural autonomy; promoting commercial dealings between tribes and non-Indians; and promoting tribal self-determination<sup>108</sup>. A finding that extending immunity to the entity would support some or all of these policies weighs in favor of a finding that it shares the tribe's immunity.

The nature of the entity's purpose is also given weight by several courts, but in varying amounts. Courts typically enquire whether the entity was organized for governmental or commercial purposes.<sup>109</sup> However, the distinction between the governmental and commercial purposes is not always clear. For example, a tribal entity organized to operate tribal gaming enterprises was held to be organized for a "governmental purpose," based on the Indian Gaming Regulatory Act's goal to encourage tribal self-determination and its restrictions on the uses to which gaming revenues can be put.<sup>110</sup> By contrast, a for-profit corporation formed to carry out construction projects was considered to have a commercial purpose.<sup>111</sup> While court determinations are difficult to predict, tribal entities that deal with traditional government functions, such as health, education, and the welfare of tribal members, are more likely to be considered "governmental," than for-profit entities whose primary activity is conducting an off-reservation business.

Several other factors are relevant in determining a tribal entity's ability to exercise sovereign immunity. The first is whether the entity holds title to property in its own name.<sup>112</sup> Evidence that the tribe holds title to the entity's property weighs in favor of a finding of sovereign immunity. The second is whether the entity is incorporated. In at least one court, the fact that a tribal entity is incorporated provided the court with strong evidence that the entity is separate and distinct from the tribe and therefore cannot share its immunity.<sup>113</sup> Clearly, if extended, this reasoning would preclude all tribal corporations from exercising sovereign immunity. At this point, however, it is just one of the factors considered.

In conclusion, the guiding principle is that the closer and more inter-connected the tribe is with the tribal entity, the more likely it is that the entity shares the tribe's immunity, particularly if the entity's purpose relates to core governmental functions.



**KEY STEPS TO PROTECT THE CORPORATE VEIL  
AND TO LIMIT LIABILITY**

- **Adequate capitalization.** Adequately capitalize the corporation. Do not allow the corporation to be financially dependent on the parent/shareholders for working capital.
- **Compliance with legal requirements for issuance of stock.** Make sure stock is issued and that you have complied with applicable legal requirements relating to issuance of a security.
- **Maintenance of corporate records.** Maintain corporate records, including minutes of shareholders' and directors' meetings held at least annually.
- **Maintenance of separate financial records and bank accounts.** Maintain separate financial records for each subsidiary. Keep balance sheets and profit and loss statements for each year. Maintain separate bank accounts for each subsidiary and parent.
- **Avoidance of inter-corporate loans.** Make few loans between the parent and the subsidiary. Document all loans made and make payments in accordance with the repayment terms.
- **No guarantees by tribe of subsidiary's debt.** The parent entity (e.g., the tribe) should not generally assure corporate creditors that it will take care of subsidiary obligations if the subsidiary is unable to do so.
- **No assignment of contracts between tribe and subsidiary.** Make sure that contracts that are intended to bind only the subsidiary are only in the name of the subsidiary. Don't put them in the name of the parent and then assign to the subsidiary.
- **No representation that the entity's primary purpose is to limit liabilities.** Never suggest to a third party that the entity was created for the purpose of limiting the legal remedies or assets available to third parties.
- **Maintenance of adequate insurance.** Maintain appropriate insurance coverage for the subsidiary's insurable liabilities.
- **No interlocking or identical boards.** Avoid having the same group of individuals serve as officers and/or directors of both the parent and the subsidiary.

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## ENDNOTES

<sup>1</sup> Stephen Cornell and Joseph Kalt, “Reloading the Dice--What can Tribes Do? Strategies and Institutions in American Indian Economic Development.” Harvard Project on American Indian Economic Development.

<sup>2</sup> Jonathan Taylor, “Good Corporate Governance for Tribal Enterprises,” Reservation Economic Summit 2005, Developing your Political, Legal, and Corporate Infrastructure (February 8, 2005), p. 6.

<sup>3</sup> Michael W. Cameron, “A Prototypical Economic Development Corporation for Native American Tribes,” Malcolm Wiener Center for Social Policy, Harvard Project on American Indian Economic Development.

<sup>4</sup> 25 U.S.C. § 477.

<sup>5</sup> *United States v. Wheeler*, 433 U.S. 313 (1978); *Powers of Indian Tribes*, 55 Interior Decisions 14 (1934).

<sup>6</sup> *Kerr-McGee Corp v. Navajo Tribe*, 471 U.S. 195, 200 (1985).

<sup>7</sup> 25 U.S.C. § 473a and the Oklahoma Indian Welfare Act, 25 U.S.C. § 501.

<sup>8</sup> *Barker v. Menominee Nation Casino*, 897 F. Supp. 389, 391 (E.D. Wis. 1995)(Menominee Casino operated by the Menominee Tribal Gaming Commission a wholly-owned chartered business venture of the tribe created by ordinance pursuant to the Constitution and By-laws of the tribe); *Pueblo of Santa Ana v. Hodel*, 663 F. Supp. 1300, 1302 (D.C.C. 1987)(Santa Ana Enterprise created by tribal ordinance passed by the traditional government of the Pueblo).

<sup>9</sup> *Unique v. Gila River Pima-Maricopa*, 674 P.2d 1376, 1382 (Ariz. App. 1983) (Gila River Farming venture was a subordinate economic entity of the tribe and not part of its corporate entity).

<sup>10</sup> *Donovan v. Navajo Forest Products Industries*, 692 F. 2d 709, 710(10<sup>th</sup> Cir. 1982).

<sup>11</sup> Jonathan Taylor, p. 6, “Good Corporate Governance for Tribal Enterprises,” Reservation Economic Summit 2005, Developing your Political, Legal, and Corporate Infrastructure (February 8, 2005).

<sup>12</sup> *Kiowa Tribe of Okla. v. Manufacturing Technologies, Inc.*, 523 U.S. 751, 754 (1998).

<sup>13</sup> *Multimedia Games, Inc. v. WLGC Acquisition Corp.* 214 F.Supp.2d 1131, 1135 (N.D. Okla. 2001).

<sup>14</sup> *Santa Clara Pueblo v. Martinez*, 436 U.S. 49 (1978).

<sup>15</sup> *Kiowa Tribe of Oklahoma*, 523 U.S. at 757-758 (1998); *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996); *Multimedia Games, Inc. v. WLGC Acquisition Corp.* 214 F.Supp.2d 1131, 1135 (N.D. Okla. 2001).

<sup>16</sup> *Id.* At 760.

<sup>17</sup> *Kiowa Tribe of Oklahoma*, 523 U.S. at 757-758 (1998); *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996); *Allen v. Gold County Casino*, No. 05-15332, 9<sup>th</sup> Circuit Court of Appeals, (Sept. 29, 2006); *Multimedia Games, Inc. v. WLGC Acquisition Corp.* 214 F.Supp.2d 1131, 1135 (N.D. Okla. 2001).

<sup>18</sup> *Id.*

<sup>19</sup> *Navajo Tribe v. Bank of New Mexico*, 700 F.2d 1285 (10<sup>th</sup> Cir. 1983).

<sup>20</sup> *Gaines v. Ski Apache* 8 F. 3<sup>rd</sup> 726, 729 (10<sup>th</sup> Cir. 1993); *In re Greene*, 980 F. 2d. 590, 593 (9<sup>th</sup> Cir. 1992); *Barker v. Menominee Nation Casino*, 897 F. Supp. 389, 393 (E.D. Wis. 1995).

<sup>21</sup> *Oklahoma Tax Commission v. Citizen Band of Potawatomi Tribe of Oklahoma*, 498 U.S. 505, 509 (1991) (recognizing tribal sovereign immunity from suit over taxation of cigarette sales).

<sup>22</sup> *Hydrothermal Energy Corp. v. Fort Bidwell Community Council*, 216 Cal. Rep. 59 (Cal. App. 1985).

<sup>23</sup> *C & L Enterprises, Inc. v. Citizen Band Potawatomi Tribe of Indian of Oklahoma*, 552 U.S. 411, 418-420 (2001).

<sup>24</sup> Four revenue rulings address the tax status of tribal governments: Rev. Rul. 67-284, 1967-2 C.B. 55; Rev. Rul. 81-295, 1981-2 C.B. 15; Rev. Rul. 94-16, 1994-1 C.B. 19; and Rev. Rul. 94-65, 1994-2 C.B. 14; GAO/GGD-97-91, Tax Policy: A Profile of the Indian Gaming Industry (May 1997).

<sup>25</sup> Rev. Rul. 67-284, 1967-2 C.B. 55.

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<sup>26</sup> Rev. Rul. 57-128, 1957-1 C.B. 311. The Service's "instrumentality" test does not generally apply for income tax exemption, but it is utilized for other tax purposes. See, e.g., PLR 200621010 (Feb. 1, 2006) (entity treated as instrumentality of a Tribe for purposes of Code Section 7871(a) (ability to receive charitable contributions).

<sup>27</sup> Title II of Pub. L. No. 100-203, 96 Stat. 2605 (1982).

<sup>28</sup> The USDA B&I regulations can be found at <http://www.rurdev.usda.gov/>.

<sup>29</sup> The SBA 7(a) regulations can be found at 13 CFR. 120 and <http://www.sba.gov/services/financialassistance/sbaloantopics/7a/index.html>.

<sup>30</sup> Id.

<sup>31</sup> See, e.g., PLR 9847018 (August 21, 1998), (a tribe's Section 17 corporation treated as qualified issuer); PLR 9826005 (March 20, 1998) (tribe's wholly owned state law corporation is not an integral part of the tribe, and thus not a qualified issuer); PLR 8702017 (October 9, 1986), (tribal tax commission is an integral part of tribe and will be treated like the tribal government for all Section 7871 purposes including tax exempt bonds).

<sup>32</sup> PLR 200225010 (March 8, 2002) (intertribal authority is an instrumentality); PLR 8638025 (June 20, 1986) (joint city- tribal commission is an instrumentality).

<sup>33</sup> Definition of Essential Governmental Function under Section 7871, 71 Fed.Reg.45474 (Aug. 9, 2006).

<sup>34</sup> Lyn Corum, Financing Distributed Generation in the New Energy Marketplace, Distributed Energy, The Journal for Onsite Power Solutions (November/December 2004).

<sup>35</sup> PLR 200635002 (Sep. 1, 2006).

<sup>36</sup> PLR 9826005 (March 20, 1998) (tribal health entity not a political subdivision because it was not delegated any sovereign powers); PLR 8702017 (Oct. 9, 1988) (tribal tax commission not a political subdivision because it was an integral part of the tribe).

<sup>37</sup> See H.R. Conf. Rep. No. 97-984, at 15 (1982), 1983-1 C.B. 522

<sup>38</sup> Rev. Proc. 84-37, 1984-1 C.B. 513 provides procedures for a political subdivision of an Indian tribal government not included on the list published in Rev. Proc. 84-36 to request a ruling qualifying it for treatment as a political subdivision as provided under Section 7871(d) of the Tax Code.

<sup>39</sup> See, e.g., Rev. Proc. 2006-4, 2006-1 I.R.B. 132.

<sup>40</sup> Rev. Rul. 87-2, 1987-2 C.B. 18.

<sup>41</sup> Rev. Rul. 67-284, 1967-2 C.B. 55 and Rev. Rul. 94-16, 1994-1 C.B. 19.

<sup>42</sup> In Private Letter Ruling 200148038 (Aug. 30, 2001), the IRS held that a local governing body that delegated certain police powers over local tribal matters was a political subdivision of an Indian tribal government. The local governing body was formed by a committee of the governing body of an Indian tribe and delegated police powers. The local body provided 24-hour law enforcement and detention services on the reservation. It also was permitted to adopt certain ordinances, including ordinances to amend the land use plan; to acquire property by eminent domain; zoning ordinances; ordinances for the enforcement of general health, safety, and welfare of the community; and local taxes. IRS reasoning focused on the fact that the local governing body had been delegated substantial governmental powers. In ruling that the local body qualified as a political subdivision of the Indian tribe, the IRS stated that the Department of Interior had opined that the Indian tribe effectively delegated sovereign powers to the local body. Accordingly, after consultation with the Secretary of Interior, the IRS concluded that the Authority was a political subdivision for purposes of Section 7871 of the Code. See also PLR 200635002 (Sep. 1, 2006), *supra* note 31 and accompanying text.

<sup>43</sup> See Chapter II.A(5), *supra*.

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<sup>44</sup> Treas. Reg. § 301.7701-1(a)(3) (“tribes incorporated” under Section 17 of the IRA of Section 3 of the OIWA are “not recognized as separate entities for federal tax purposes”). In referring to “tribes incorporated” under Section 17, the IRS regulations are following the statutory language of 25 U.S.C. § 477, which refers to the “incorporated tribe”. Cf. § 301.7701-2 (b)(1) (defining a corporation to include any business entity organized under a federal, state or tribal statute if the statute refers to the entity as incorporated).

<sup>45</sup> See Treas. Decision 8697, 61 Fed. Reg. 66585 (Dec. 17, 1996). However, in regulations issued in 1997 under Internal Revenue Code section 337(d), the IRS limited the definition of tax-exempt Indian tribal corporations to those incorporated under federal law--specifically, section 17 of the IRA and section 3 of the OIWA. See Treas. Reg. §1.337(d)-4(c)(2)(v).

<sup>46</sup> See Internal Revenue Manual, § 4.88.1.4.1(6)(a).

<sup>47</sup> See Cohen's Handbook of Federal Indian Law, § 8.02[2] [a] citing Ellen P. April, "The Integral, the Essential and the Instrumental: Federal Income Tax Treatment of Governmental Affiliates," 23 Exempt Organization Tax Review 263, 267-269 (Feb. 1999) (discussing the integral part test).

<sup>48</sup> See, e.g., Florida Residential Property and Casualty Joint Underwriting Association v. United States, 207 F. Supp. 2d 1344, 1349 (N.D. Fla. 2002); Rev. Rul. 87-2, 1987-2 C.B. 18; Rev. Rul. 71-131, 1971-2 C.B. 28; Rev. Rul. 71-132, 1971-1 C.B. 29. See also PLR 199909013 (Nov. 25, 1998) (if an enterprise is deemed to be an integral part of the state, it will not be treated as a separate entity for tax purposes).

<sup>49</sup> PLR 200031045 (May 9, 2000) (a nonprofit corporation created pursuant to a city ordinance); and PLR 200112013 (Dec. 14, 2000) (a tribally-chartered authority created by a Tribe to construct and manage its gaming business).

<sup>50</sup> Cal. Admin. Code title. 18, sec. 1616.

<sup>51</sup> See Oklahoma Tax Commission v. Chickasaw Nation, 115 S.Ct. 2214 (1995) (noting the Oklahoma Tax Commission's current policy with regard to the sales and use tax exemption applicable to Indian tribes).

<sup>52</sup> See Code section 7871(c). However, in some private letter rulings, the IRS has stated or implied that such debt may also be issued by "an integral part of an Indian tribal government." See PLR 9826005 (June 26, 1998) (concluding that a state-chartered nonprofit corporation did not qualify as an "integral part" or a political subdivision of an Indian tribe, and thus could not issue tax-exempt bond). See TAM 9013002 (March 30, 1990) (activities of certain subsidiaries of a tribe, such as logging, agricultural and general retail operations, are not essential governmental functions, even though such subsidiaries provide funding to tribal government programs which in turn provide essential governmental functions).

<sup>53</sup> See 13 C.F.R. §124.109 (requirements for tribal entities under Section 8 (a)); 13 C.F.R. §120.111 (exception for tribal government entities under SBA loan rules).

<sup>54</sup> 25 U.S.C. §477; American Vantage v. Table Mountain Rancheria, 292 F.3d 1091, 1098 (9<sup>th</sup> Cir. 2002).

<sup>55</sup> Atkinson v. Haldane, 569 P.2<sup>nd</sup> 151, 174-175 (Alaska 1977).

<sup>56</sup> 25 C.F.R. Part 82.

<sup>57</sup> Tribes in Oklahoma may reorganize under the provisions of the Oklahoma Welfare Act, 25 U.S.C. 501-509 (1936).

<sup>58</sup> Id.; Specific laws affect the governmental authority of the Osage and Five Civilized Tribes of Oklahoma.

<sup>59</sup> 25 U.S.C. §477 (as amended 1990).

<sup>60</sup> 25 C.F.R. 25 U.S.C. §84.004(b).

<sup>61</sup> 25 C.F.R. 25 U.S.C. §84.004(f).

<sup>62</sup> Maryland Cas. Company v. Citizens National Bank, 361 F. 2<sup>nd</sup> 517 (5<sup>th</sup> Cir.) cert. denied, 385 U.S. 918 (1966); Parker Drilling v. Metlakatla Indian Community, 451 F. Supp. 1127 (D. Alaska 1978).

<sup>63</sup> See BIA Model Charter Art. VII K. and Art. XVI (modifies “sue and be sued clause” so it subject to provision on immunity).

<sup>64</sup> 25 USC § 476 provides that the tribe must consent to transfer of tribal assets.



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- <sup>65</sup> *Atkinson v. Haldane*, 569 P.2<sup>nd</sup> 151 (Alaska 1977).
- <sup>66</sup> Four revenue rulings address the tax status of tribal governments: Rev. Rul. 67-284, 1967-2 C.B. 55; Rev. Rul. 81-295, 1981-2 C.B. 15; Rev. Rul. 94-16, 1994-1 C.B. 19; and Rev. Rul. 94-65, 1994-2 C.B. 14.
- <sup>67</sup> Rev. Rul. 87-2, 1987-2 C.B. 18.
- <sup>68</sup> Rev. Rul. 67-284, 1967-2 C.B. 55, Rev. Rul. 81-295, 1981 C.B. 15, and Rev. Rul. 94-16, 1994-1 C.B. 19.
- <sup>69</sup> Rev. Rul. 81-295, Rev. Rul. 67-284, 1967-2 C.B. 55 and Rev. Rul. 94-16, 1994-1 C.B. 19; Treas. Reg. § 301.7701-1(a)(3) (“tribes incorporated” under Section 17 of the IRA and Section 3 of the OIWA are “not recognized as separate entities for federal tax purposes”).
- <sup>70</sup> Rev. Rul. 94-65, 1994-2 C.B. 14.
- <sup>71</sup> PLR 9847018 (November 20, 1998) (citing Rev. Rul. 94-16 “that Section 17 Corporation has the same tax status as the tribe.”).
- <sup>72</sup> See, e.g., *Johnson v. Harrah's Kansas Casino Corp.*, 2006 WL 463138 (D. Kan. 2006); *In re Ransom*, 86 N.Y.2d 553, 559 (1995); *Dixon v. Picopa Construction Co.*, 772 P.2d 1104, 1110 (Ariz. 1989).
- <sup>73</sup> *In re Ransom*, 86 N.Y.2d 553, 559 (1995).
- <sup>74</sup> *McNally CPA's & Consultants, S.C. v. DJ Hosts, Inc.*, 692 N.W.2d 247, 250 (Wis. Ct. App. 2004).
- <sup>75</sup> 319 U.S. 436 (1943)
- <sup>76</sup> 1994-1 C.B. 19
- <sup>77</sup> PLR 9826005 (March 20, 1998). In the ruling, the IRS also concluded that the corporation was not a political subdivision of the tribe since there was no evidence it had been delegated any sovereign or governmental powers.
- <sup>78</sup> Rev. Rul. 2004-50, 2004-22 I.R.B. 977.
- <sup>79</sup> There are certain exceptions to this general rule. For instance, an LLC that engages in public trading of its interests will be treated as an association taxable as a corporation.
- <sup>80</sup> There is one important caveat. Unlike partnership laws, which have some uniformity across states, LLC laws have not attained such uniformity, and as such, there are significant differences in the LLC laws of different states. Thus, an LLC that wishes to conduct business in a state other than its state of organization should closely review the LLC status of that state to determine whether the statute extends the expected treatment to foreign (i.e., out-of-state) LLCs.
- <sup>81</sup> See Del. Code, tit. 16, 318-303(a)
- <sup>82</sup> See Del. Code, tit. 16, 318-303(b)
- <sup>83</sup> Three features limit the usefulness of relying on this decision. First, it was a superior court opinion, which is not binding on any other courts, even within the state. Second, the opinion was not published, which in many jurisdictions, precludes parties from even citing to or mentioning the case. Third, the statement was “dicta” because the tribe did not assert sovereign immunity as a defense.
- <sup>84</sup> *Webster v. Pequot Mystic Hotel, LLC*, 2004 WL 239738 (Conn. Super.) (unpublished opinion).
- <sup>85</sup> *Warburton/Buttner v. Superior Court*, 103 Cal. App. 4th 1170, 1189 (2002).
- <sup>86</sup> There are certain exceptions to this general rule. For instance, an LLC that engages in public trading of its interests will convert to an association taxable as a corporation. Similarly, certain states that do not recognize the non-taxable nature of LLCs, partnerships and other flow-through entities.
- <sup>87</sup> There is one important caveat. Unlike partnership laws, which have some uniformity across states, LLC laws have not attained such uniformity, and as such, there are significant differences in the LLC laws of different states. Thus, an LLC that wishes to conduct business in a state other than its state of organization should closely review the LLC statute of that state to determine whether the statute extends the expected treatment to foreign (i.e., out-of-state) LLCs.
- <sup>88</sup> *Warburton v. Superior Court*, 103 Cal. App. 4th 1170 (2002).
- <sup>89</sup> *Id.* at 1188.
- <sup>90</sup> *Id.* at 1175.
- <sup>91</sup> See *Johnson v. Harrah's Kansas Casino Corp.*, 2006 WL 463138 (D. Kan. 2006) (application of factors to state-chartered corporation that managed the tribe's casino).
- <sup>92</sup> Cf. *McNally CPA's & Consultants, S.C. v. DJ Hosts, Inc.*, 692 N.W.2d 247, 250 (Wis. Ct. App. 2004) (subsequent tribal purchases of existing businesses do not bestow sovereign immunity on such entities).

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<sup>93</sup> Some states, including California, require limited partnerships to pay an annual "fee" of several hundred dollars for the privilege of doing business in California; other states, such as Illinois, may impose an income tax at the entity level.

<sup>94</sup> See Internal Revenue Manual § 4.88.1.4.1 [Federal Tax Status of Indian Tribal Governments] (01-01-2003).

<sup>95</sup> Id.

<sup>96</sup> See T.D. 8697, 1997-1 C.B. 215. A Treasury Decision ("T.D.") is the IRS' official commentary on federal tax regulations.

<sup>97</sup> Treas. Reg. § 301.7701-3(a).

<sup>98</sup> See Treas. Reg. § 301.7701-2(b)(6).

<sup>99</sup> Certain rules apply to determine when such income will be recognized or included in the partner's gross income.

<sup>100</sup> In Rev. Proc. 1993-27, 1993-2 C.B. 343, the IRS noted that a profits interest received in exchange for the provision of services to a partnership would not be treated as taxable income to the partner unless: (i) the interest relates to a substantially certain or predictable stream or income; (ii) the partner disposes of the interest within two years; or (iii) the interest is a limited partnership interest in a "publicly traded" partnership. See also Rev. Proc. 2001-43, 2001-2 C.B. 191.

<sup>101</sup> Where the partnership agreement does not provide for such allocations, the distributive shares are determined according to the partners' interest in the partnership.

<sup>102</sup> The UBTI rules come into play only when a tribe operates a tribal college or university. See Code Sections 7871(a)(5) and 511(a)(2)(B).

<sup>103</sup> The recently enacted Energy Policy Act of 2005 provides for tax-credit financing of "clean renewable energy facilities" by tribal governments and their political subdivisions.

<sup>104</sup> See, e.g., *Wright v. Colville Tribal Enterprise Corp.*, 111 P.3d 1244, 1250 (Wash. Ct. App. 2005).

<sup>105</sup> Id.; *Runyon v. Ass'n of Village Council Presidents*, 84 P.3d 437, 440-41 (Alaska 2004).

<sup>106</sup> *Dixon v. Picopa Construction Co.*, 772 P.2d 1104, 1110 (Ariz. 1989).

<sup>107</sup> See, e.g., Id. at 1107-08, 1109.

<sup>108</sup> See, e.g., Id. at 1111-12; *Trudgeon v. Fantasy Springs Casino*, 71 Cal. App. 4th 632, 642 (1999).

<sup>109</sup> See, e.g., *Gavle v. Little Six, Inc.*, 555 N.W.2d 284, 294 (Minn. 1996).

<sup>110</sup> Id. at 294-95; *Trudgeon*, 71 Cal. App. 4th at 639-40.

<sup>111</sup> *Dixon*, 772 P.2d at 1110-11.

<sup>112</sup> Id. at 1108; *White Mountain Apache Indian Tribe v. Shelley*, 480 P.2d 654, 656 (Ariz. 1971).

<sup>113</sup> *Dixon*, 772 P.2d at 1110-11.





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