Tribal Economic Development Bonds - An Executive Summary for Tribal Leaders

What Law Authorizes Tribal Economic Development Bonds?

On February 13, 2009, Congress passed the American Recovery and Reinvestment Act of 2009 ("ARRA" or "Recovery Act"), a $787 billion recovery package intended to stimulate the U.S. economy out of recession. The ARRA consists of supplemental appropriations for federal spending, as well as tax incentives, state fiscal relief and other provisions. Section 1402 of the ARRA amends the Indian Tribal Governmental Tax Status Act of 1982, 26 U.S.C. §7871 ("Indian Tax Status Act") to permit, for the first time, "Tribal Economic Development Bonds" (TEDBs).

What is a Tax-Exempt Bond and Why is the Authority to Issue Tax-Exempt Bonds Important?

A bond is a type of loan. The issuer (except in the case of private activity) is the borrower. The purchaser of a bond is the lender. A bond normally has a longer term than a business loan and is capable of being freely bought and sold by the bondholders. When a bond qualifies as tax-exempt under the Internal Revenue Code, the holders of the bonds do not have to pay federal income tax on the interest payments they receive. This normally means that they are willing to accept a lower rate of interest because the tax exemption increases their net return on investment. The result for the borrower is lower debt costs.

What Bonds Could Tribes Issue Before the Recovery Act?

Until now, under the Indian Tribal Governmental Tax Status Act tribes could issue tax-exempt bonds to finance "essential government functions," such as schools, streets and sewers. The Internal Revenue Service, however, has long limited the types of activities that tribal governments can finance with these bonds by mandating that the financed activity must have been conducted by numerous state and local governments, for many years, and that the activity must not be a commercial or industrial activity. There has been a vigorous debate over tribes' efforts to finance golf courses, hotels and convention centers with tax-exempt bonds.

How was the Tribes' Authority different from State and Municipal Bond Authority Before the Recovery Act?

State and local governments are not restricted to essential government functions with respect to their tax-exempt bond authority. They have been able to use tax-exempt bonds to finance certain activities, such as the development of convention centers, hotels, sports facilities and even gaming-related facilities that Indian tribes have not been allowed to finance because of the "essential government function" limitation in the Indian Tax Status Act.

In addition, under Section 141(e) of the Internal Revenue Code of 1986, as amended, state and local governments are able to use tax-exempt bonds to finance certain activities, even if the proceeds of the bond issuance ultimately accrue to private parties. Indian tribal governments have never been authorized to issue these "private activity bonds."

How do Tribal Economic Development Bonds Help Equalize the Treatment of Tribes and States?

Section 1402 authorizes the allocation of up to $2 billion worth of "Tribal Economic Development Bonds." TEDBs can be used by Indian tribal governments to finance any activity that a state or local government can finance using tax-exempt bonds, except that (1) proceeds may not be used to finance "any portion of a building in which class II or III gaming is conducted or housed or any other property actually used in the conduct of such gaming," and (2) the project must not be "located outside the Indian reservation."

Tribal Economic Development Bonds are important because they

* remove the disparity as to the types of government-owned facilities that can be financed with tax-exempt bonds by state and local governments, on the one hand, and tribal governments, on the other, and
* open the door to the issuance by tribal governments of certain qualified private activity bonds.

What Three Types of Bonds are Tribes now Authorized to Issue?

As a result of the ARRA, tribes now have the authority to issue three different types of bonds:

1.) Essential Government Function Bonds

These are the bonds that were authorized by the Indian Tribal Status Act of 1982. There is no limit to the amounts of these bonds that tribes can issue. They can be used to finance traditional government facilities such as

* Roads
* Parks
* Water and Wastewater systems
* Government buildings
* Schools
* Etc.

2.) Tribal Economic Development Government Bonds

Tribal Economic Development Government Bonds are one of the types of Tribal Economic Development Bonds authorized for the first time by the ARRA. They are subject to a $2 billion cap. They can be used to finance projects and facilities owned by tribes but outside the scope of "essential governmental function" bonds, such as

* Convention centers
* Golf courses
* Sports facilities
* Hotels
* Restaurants
* Water parks
* Entertainment facilities
* Marinas
* Etc.

3.) Qualified Private Activity Tribal Economic Development Bonds

Private activity bonds are bonds issued by states, municipalities and now tribes, the proceeds of which are re-loaned to private entities. While a project financed by a Tribal Economic Development Government Bond, discussed above, must be owned by the tribe that issues the bonds, a project that is financed by a qualified private activity bond can be owned by a tribal joint venture or third party investor.

Generally, a bond is a "private activity bond" if more than 10% of the proceeds of the bond are used in a trade or business carried on by a person other than a governmental unit (a "private business use"), and if the payment of more than 10% of the principal of and interest on a bond issue is secured by an interest in, or payments made with respect to, property used in such a trade or business.

If a private activity bond is issued by a state or local government, or, with respect to the $2 billion worth of Tribal Economic Development Bonds, by an Indian tribal government, interest on the bond will only be exempt from federal income tax if the bond is one of seven types of "qualified bonds" used for purposes that the U.S. Congress has deemed deserving of public support.

A full discussion of private activity bonds is beyond the scope of this executive summary. There are strict limitations and qualifications on the issuance of private activity bonds that must be carefully reviewed to determine their suitability for a particular project. Types of qualified private activity bonds include:

* Exempt Facilities Bonds to finance the construction of (i) water and sewage facilities, (ii) residential rental projects, (iii) local district heating or cooling facilities falling within the parameters of the IRC, (iv) qualified hazardous waste facilities, (v) environmental enhancements of hydroelectric generating facilities, (vi) qualified public educational facilities, subject to caps, and (vii) certain other defined facilities described at IRS Section 142.
* Qualified mortgage bonds to finance the purchase, and in some cases, the repair or rehabilitation, of owner-occupied single-family homes located in the jurisdiction of the issuer, provided IRS requirements are met.
* Qualified veterans' mortgage bonds are tax-exempt bonds that may be issued to finance veterans' purchases of owner-occupied single-family homes. However, under Section 142(l)(2) of the Code, qualified veterans' mortgage bonds may only be issued by a state that issued such bonds before June 22, 1984.
* Qualified small issue bonds to finance manufacturing facilities (more commonly known as industrial development revenue bonds).
* Qualified student loan bonds under Section 144(b) of the Code.
* Qualified redevelopment bonds to finance the redevelopment of blighted areas, or areas determined to be blighted based on the substantial presence of certain factors, including excessive vacant land on which structures were previously located, abandoned or vacant buildings, substandard structures, vacancies, and property tax delinquencies.
* Qualified 501(c)(3) bonds to fund the exempt activities (and not the unrelated businesses, if any) of a 501(c)(3) organization, and if any property provided by the bond proceeds is owned by a 501(c)(3) organization or a governmental unit.

Applying for Tribal Economic Development Bonds Section 1402 of the ARRA provides that "[t]he Secretary shall allocate the national tribal economic development bond limitation among the Indian tribal governments in such manner as the Secretary [of the Treasury], in consultation with the Secretary of the Interior, determines appropriate." The national limit is $2 billion. Neither the Act itself nor the "Joint Explanatory Statement of the Committee of Conference" provides additional information regarding the allocation process. Since Section 1402 also requires that the Secretary perform a study on the law and report back to Congress within one year, some expeditious means of allocation seems necessary. The Treasury Department is accepting comments on the allocation process until March 30th.