

Treasury Department and IRS Provide New Allocation Guidelines for Approximately \$1.8 Billion of TEDB Volume Cap

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Attorney Articles

On July 16, 2012, the Department of Treasury (“Treasury”) and the Internal Revenue Service (the “IRS”) released Notice 2012-48 (the “Notice”), establishing new guidelines for allocating approximately \$1.8 billion dollars in issuance authority for tribal economic development bonds (“TEDBs”).

As described in our earlier Alerts, TEDBs are a financing tool created by the American Recovery and Reinvestment Act of 2009 (“ARRA”). This financing tool, codified as section 7871(f) of the Internal Revenue Code of 1986, as amended (the “Code”), allows Indian tribal governments, for the first time, to issue tax-exempt bonds for the same purposes as state and local governments without regard to two existing limitations: (1) the “essential governmental function” test, which the IRS has interpreted to bar certain projects that it believes are “commercial” in nature, and (2) the prohibition against the issuance of “private activity bonds” (other than for certain manufacturing facilities).

In authorizing TEDBs, ARRA imposed a \$2 billion national volume cap on total issuance. Under previous IRS guidance, the entire \$2 billion was allocated to tribes in 2009 and 2010. The original allocations, however, were subject to sunset provisions if tribes receiving the allocations were unable to complete their proposed financing transactions by prescribed sunset dates. As a result, over \$1.8 billion of the original \$2 billion in volume cap allocations was forfeited as of March 31, 2012.

Release of the Notice follows a 2011 IRS Announcement seeking comments from tribes and industry groups on how to re-allocate issuance authority for TEDBs. In response to the 2011 Announcement, numerous tribes and industry groups submitted comments on how to effectively allocate the remaining TEDB volume cap. The Notice follows those comments in significant part. In general, the Notice substantially modifies prior requirements for allocating TEDB volume cap and also promulgates a new application form for tribes to use when requesting volume cap from the IRS.

This Alert highlights the key requirements set forth in the Notice and also offers some strategic considerations on how tribes can more effectively make use of the TEDB financing program going forward.

New Allocation Methodology

Former Methodology. The Notice significantly modifies prior guidance for allocating TEDB volume cap. Prior guidance reflected an underlying policy directive of ARRA to provide expeditious economic stimulus and, as a result, the Treasury and IRS,

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pursuant to Notice 2009-51, moved quickly to adopt an application process for allocating TEDB volume cap, soliciting applications for allocations from tribes with qualifying projects. In response, tribes submitted allocation applications on an expedited basis and, within a matter of months, the entire \$2 billion of volume cap was awarded. Unfortunately, most of the transactions for which TEDB volume cap was awarded were not completed. While one goal of the original methodology, allocating TEDB volume cap quickly to tribal applicants, succeeded, the ultimate goal of stimulating economic development was largely frustrated by a wide scale lack of success in bringing TEDB financings to fruition.

First-Come, First-Served System. The Notice, in contrast to prior methodology, establishes an allocation system whose goal is to make more effective, if less expeditious, use of TEDB financing authority. Under the Notice, tribes, in order to receive allocation awards, will be required, among other things, to more objectively demonstrate the financial viability of their proposed projects. The new system is a first-come, first served methodology, but is conditioned, among other things, on a requirement that applicants demonstrate on an objective basis their "readiness to issue." Underscoring this requirement, volume cap allocations will now have shelf lives of only 180 days. If a tribe receiving an allocation cannot close its proposed TEDB financing transaction within that time, its allocation will sunset and be returned to the remaining pool of TEDB volume cap for re-allocation by the IRS. Unlike former methodology, the IRS does not plan to extend sunset dates. A tribe that cannot close its TEDB financing within 180 days will not be able to request an extension. It may re-apply for a new allocation, but the new application must disclose the forfeited allocation, and such a disclosure may adversely impact the tribe's ability to demonstrate its readiness to issue.

The triggering event for this new first-come, first-served system is the date of submission by applicants of their allocation applications to the IRS. That is, allocations will be awarded according to their dates of submission. The Notice makes clear, however, that the IRS plans to undertake a review process to determine whether submitted applications are complete. If the IRS concludes that an application does not provide all the information required by the Notice, the submission date will not be deemed to occur until all required information has been submitted.

Increased Cap. The Notice significantly raises the former \$30 million cap on TEDB allocations. Going forward, the maximum allocation that can be awarded to any tribe (including for this purpose political subdivisions of and entities controlled by the tribal government) will be raised to an amount equal to 20% of the remaining volume cap at any particular time, as published by the IRS for successive two-month periods, commencing no later than October 1, 2012 (initially, approximately \$360 million), until the remaining volume cap has reached \$500 million, at which point the maximum allocation will be \$100 million.

Permitted Assignments. The Notice provides new guidance on the ability of a tribe to assign a TEDB allocation to certain "qualified issuers." Under the Notice, a tribe receiving an allocation may assign its allocation to any of the following qualifying issuers: (a) a Section 17 Corporation formed by the tribe; (b) a subdivision of the tribe that meets the test for being a political subdivision of a state; or (c) a "pool bond issuer," as described in the Notice (a qualifying tribal issuer that issues obligations the proceeds of which are loaned to multiple TEDB allocation recipients).

New Reporting Requirement. A new reporting requirement is introduced by the Notice, presumably to assist the IRS in tracking volume cap availability. Not later than 15 days after any issuance of TEDBs, the applicant must submit to the IRS a Notice of Issuance with certain required information. This notice confirms that the TEDB allocation has in fact been used. In addition, customary information reporting requirements continue to apply to TEDBs, requiring the filing of a Form 8038-G after a TEDB financing has been completed.

Deviations from Information Initially Reported to IRS. The Notice modifies prior rules governing deviations in project or financing details from what was originally disclosed to the IRS in a tribe's allocation application. If the details of a TEDB financing, or of the project being financed, differ from what the tribe disclosed to the IRS, the Notice makes clear that the deviation will not invalidate the corresponding TEDB allocation if the deviation is "insubstantial," and if the insubstantial deviation is disclosed to the IRS. If an insubstantial deviation occurs before submission of the Notice of Issuance, the Notice of Issuance must include a description of the insubstantial deviation. If the insubstantial deviation occurs after submission of the Notice of Issuance, the applicant must submit to the IRS a supplement to the Notice of Issuance describing the insubstantial deviation.

It should be noted that these rules may entail greater risk to TEDB issuers than what may appear at first glance. This risk results from the fact that any determination of what is "insubstantial" is essentially a legal judgment, based on applicable federal income tax principles. Issuers making these determinations without advice from tax counsel do so at their peril. Moreover, these rules include a two-edged sword in that, first, applicants are required to disclose insubstantial deviations to the IRS on the one hand and, on the other, if disclosure is made of a deviation that does not appear to the IRS to be insubstantial, an applicant can reasonably expect the IRS to raise questions with its TEDB financing.

The Notice also provides new rules on deviations that occur after TEDBs are issued but before the proceeds are allocated to corresponding expenditures. Under the Notice, such a deviation, even if substantial, will not invalidate a TEDB allocation if the applicant submits to the IRS a supplement to its Notice of Issuance containing the following: (a) a description of the substantial deviation; and (b) a certification that the applicant has received an opinion from bond counsel to the effect that the deviation will not cause the bonds to fail to meet all applicable requirements of section 7871(f) of the Code and other applicable tax requirements under sections 103 and 141 of the Code.

New Application Process

The Notice provides a new application form for tribes to use in applying for TEDB allocations and establishes new requirements with respect to the information that tribes must provide to the IRS in their applications. The following summary highlights the more significant information requirements set forth in the Notice.

Identity of Applicant. Under the Notice, only federally recognized Indian tribes, as defined in the Notice, may apply for TEDB allocations (referred to in the Notice as "Applicants"), and all applications must be signed by authorized officials of the Applicants, as described in the Notice. Allocations may be assigned by Applicants to other qualifying issuers, as described above under "Permitted Assignments."

Submission Date. Allocation applications will be accepted by the IRS on an ongoing basis and will be acted on according to "submission date," as described

above under "First-Come, First-Served System."

Project Description. Applications must describe the type and use of the project proposed to be financed with TEDBs and Applicants must certify that the project will qualify for TEDB financing. Proceeds of TEDBs may be used only for projects described in the corresponding allocation application or permitted deviations, as described above under "Deviations from Information Initially Reported to IRS." An Applicant may include multiple projects in a single allocation application, so long as the required information for each project is included, or may submit separate applications for separate projects. An Application may be submitted for a joint project all of which will be owned by Indian tribal governments or which will, in part, be owned by an entity that is not an Indian tribal government, provided that the joint project will be located entirely on one or more of the reservations of any of the Indian tribal governments receiving an allocation with respect to such project. In its guidance on joint ownership of projects, the Notice cross-references the private activity bond restrictions contained in section 141 of the Code.

Project Location. All allocation applications must include a certification that the proposed project is located entirely within the Applicant's reservation. A joint project must be located entirely within one or more of the reservations of the Indian tribal governments receiving an allocation for the joint project.

Anti-Gaming Restriction. Like prior IRS guidance, the Notice includes a certification requirement that no portion of the proposed TEDBs will be used to finance any portion of a building in which class I or class II gaming is conducted or housed or any other property actually used in the conduct of such gaming. Under the Notice, prior guidance will apply with respect to determinations as to separate buildings.

Governmental Approvals. An application must state that all required governmental approvals applicable to the project or the financing have been obtained or else identify required approvals that have not been obtained and describe how such approvals will be obtained prior to the 180-day expiration of the allocation.

Plan of Financing. An application must contain a reasonably detailed description of the plan of financing, including, among other things, the following: (a) a description of any sources of financing needed in addition to the proposed TEDBs; and (b) documentation from an independent third party as to the marketability of the proposed TEDBs, such as one of the following (i) a bond purchase commitment letter from an investor; (ii) a credit quality assessment evidencing the investment grade quality of the proposed TEDBs from an independent organization in the business of assessing credit quality; (iii) a credit enhancement commitment letter from a financial institution that will enable the proposed TEDBs to be investment grade quality; or (iv) a letter from an underwriter or financial advisor to the effect that the issuance of the proposed TEDBs is likely to be successful before expiration of the TEDB allocation.

Readiness to Issue. An application must include a certification that the Applicant reasonably expects to issue the requested TEDBs prior to the time that the TEDB allocation expires. Based on its overall assessment of the Applicant's readiness to issue, the IRS may require the Applicant to provide additional information or supporting documentation to demonstrate its readiness to issue, and the application will be treated as incomplete until the IRS receives such information or documentation.

Strategic Considerations

Under the new guidelines set forth in the Notice, there are several considerations tribes may wish to evaluate in connection with applying for TEDB allocations, including the following:

Inclusion of Allocation Application Within Overall Financing Process. In releasing the Notice, the Treasury and IRS appear to be refocusing the process of allocating TEDB volume cap according to transactions with the best prospects for successful completion. Former guidance resulted in a wide dispersal of allocation authority, and achieved a perception of fairness, but ultimately failed to make effective use of TEDBs as a financing tool.

Tribes may want to view the TEDB program similarly by thinking of TEDBs as one part of an overall financing effort. To effectively use TEDBs, tribes may want to assemble financing teams that they believe can bring a transaction successfully to fruition, including participants who can assess relevant financial and legal considerations of the proposed transaction. Submission of an allocation application to the IRS could be incorporated into the overall financing process based on a review by the financing team of these kinds of considerations. Allocation applications should be submitted to the IRS when a tribe and its financing team have determined that a transaction can successfully be completed within 180 days.

Joint Projects. The new TEDB guidelines expressly sanction joint projects. Tribes may wish to explore situations where two or more tribes can join together to finance a joint project, particularly where one or more of the tribes has enhanced access to the credit markets and is willing to partner up with other tribes to achieve benefits that can be shared among them.

Limitations of TEDBs. Some tribes may want to delay or abandon their efforts to use TEDBs if they aren't able to develop an effective overall financing strategy that incorporates TEDBs. TEDBs may not constitute a blanket solution for all tribal financing needs.

Conclusion

Notice 2012-48 significantly revises IRS guidance on TEDBs. Please feel free to contact me (612- 343-7912; helde.richard@dorsey.com) to discuss.

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