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## **Results of Joint Research Effort by the Internal Revenue Service and the University of Michigan School of Information**

In April, 2006, researchers from the University of Michigan met with officials and researchers from the Tax-Exempt Bond division of the Internal Revenue Service to discuss the issue of tribal tax-exempt bonds. Recent enforcement activity by the IRS had created the perception in Indian Country that the IRS was being overly aggressive against tribal issuers relative to their state and local counterparts.

Section 103(c) of Tax Code treats all obligations as “bonds” even if they are bank loans, finance leases, or installment purchases, or in fact bond indentures. This treatment is the same for tribal debt under Section 7871(c) of the tax code. Thus, while the debt markets differentiate substantially between bank debt and bond indentures, the Tax Code does not.

When tribes enter into debt obligations, if the interest paid by the tribe is tax-exempt, then a form needs to be filed with the IRS. If the obligation is for an amount greater than \$100,000, then a form 8038G is filed, otherwise a form 8038GC is filed.

In response to inquiries from the University of Michigan researchers, IRS researchers determined that 88 tribes had filed one or more informational returns between January 1, 2002 and December 31, 2005 (note that this data reflects direct tribal issues only; conduit issues are not included in these figures):

Form 8038G	136
Form 8038GC	169

On either form, Line 20 allows the tribe to check a box to indicate whether the obligation is a lease or installment purchase. The data was then broken down into the following:

Form 8038GC	
Leases or Installment Sales	105
Bank Loans or Bond Indentures	64
Form 8038G	
Leases or Installment Sales	46
Bank Loans or Bond Indentures	90

The following was also determined, however, in the course of the research:

- While some tribal debt examinations were initiated from referrals, the majority of tribal debt examination cases were initiated by the IRS through its normal case selection process.
- Of the 305 filings (issues), slightly less than 1% are being examined
- Of the 88 tribes that filed, approximately 3% have bonds under examination.
- The total dollar amount of issues during this time period is around \$700,000,000.

## Additional Findings

Although a greater level of detail would of course be desirable, the IRS is limited in its ability to disclose based on rather strict confidentiality requirements. Thus, the remaining data analysis and conclusions do not necessarily reflect the views of the IRS.

Thompson Financial has reported the following for the years 2002 through 2004:

	<b>2002 Issues</b>	<b>2002 Par Amount (US\$ mil)</b>	<b>2003 Issues</b>	<b>2003 Par Amount (US\$ mil)</b>	<b>2004 Issues</b>	<b>2004 Par Amount (US\$ mil)</b>
State authority	1,943	125,595.7	1,978	119,013.3	1,884	102,837.4
Local authority	2,109	59,156.1	2,141	62,572.7	1,837	57,197.4
District	4,351	54,509.7	4,613	56,560.5	4,298	58,235.3
City, Town or Village	4,062	46,948.4	4,330	54,526.9	3,782	53,368.7
State	272	34,042.4	262	48,401.7	241	47,042.6
County /Parish	1,047	23,325.1	1,146	24,479.3	961	23,182.0
College or University	199	7,045.9	226	8,929.4	235	8,860.1
Direct Issuer	69	3,991.1	56	4,244.1	68	5,781.3
Co-op Utility	4	930.0	-	-	-	-
<b>Total</b>	<b>14,056</b>	<b>355,544.4</b>	<b>14,752</b>	<b>378,727.9</b>	<b>13,306</b>	<b>356,504.8</b>
Indian tribe	4	194.4	6	233.2	5	178.4

Source: Thompson Financial

A preliminary survey of tribal bond lawyers indicates that of for every tribal bond indenture requiring an 8038G filing, four to five bank loans are also closed that require an 8038G filing. Thus, for the 90 form 8038G filings from 2002 through 2005, assuming that 20% were for bond indentures, 18 tribal bonds indentures were issued between 2002 and 2005. The average number of tribal bond indentures issued per year is 4.5, which is essentially the same as the Thompson reported average of 5 per year (Thompson did not provide 2005 data). Municipal bond indentures of less than \$100,000 rarely exist, if at all, so the 8038GC filings have been excluded. If those are not excluded, the average number of bonds is 6 per year.

Based on information from tribes and tribal bond attorneys for tribes that are currently being audited, all of the audits for debt obligations issued between 2002 and 2005 were for bond indentures, none were for bank debt.

The three audits for bonds indentures issued between 2002 and 2005 represent 16.6% of all tribal bond indentures issued during that same time period. In contrast, assuming an even rate of auditing and issuance of state and local "bonds," the hazard rate for state and local obligations is one half of one percent (this number can be measured precisely if the IRS can determine the total number of 8038G and GC forms that were filed between 2002 and 2005).

Thus, the audit hazard rate for tribal bonds in only their first four years after issuance is more than an order of magnitude greater than the lifetime hazard rate for state and local government bonds.

More information on this issue can be found at

**<http://www.tribalfinance.org>**