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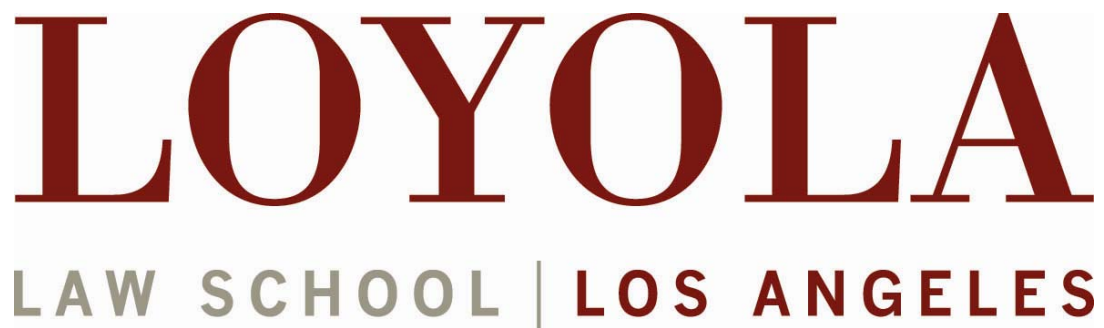
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Trial Bonds: Indian Sovereignty and the Tax Legislative Process

Professor Ellen P. Aprill

TRIBAL BONDS: INDIAN SOVEREIGNTY AND THE TAX LEGISLATIVE PROCESS

*Ellen P. Aprill**

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In tax law, as elsewhere, the federal government has treated native Americans and their tribal governments ineffectively and inconsistently. Examining the treatment of Indian tribal governments under the Internal Revenue Code demonstrates again their unique position in our federalist system.¹ The saga of recent tax laws affecting tribal governments, however, also illustrates in dramatic microcosm the relationship between ambiguous statutory language, administrative discretion, and legislative oversight.

Congress faced several competing considerations in designing tax provisions applicable to tribal governments. On one hand, tribal governments have inherent powers and attributes of sovereignty.² For example, because of this sovereign status, states cannot tax tribes or activities conducted on reservations.³ If Congress adopted a model of taxing tribal governments based on their sovereignty, it would not enact federal tax incentives designed to benefit them.⁴ On the other hand, tribal governments are dependent, not independent, nations; Congress has full authority to regulate the tribal governments. Article I, section 8 of the Constitution gives Congress the authority to "regulate Commerce . . . with the Indian Tribes."⁵ Under this so-called Indian Commerce Clause and Supreme Court cases, there is little constitutional limitation on the ability of the federal government to tax Indian tribes or tribal members.⁶ As a result, Congress faces no barriers in using the tax code as an instrument of social or economic policy, but has no particular obligation to do so. The federal government, however, has a special responsibility toward tribal governments. A trust relationship exists between the United States and the Indian tribes.⁷ As part of this fiduciary obligation, the

1. See generally Robert A. Williams, Jr., *Small Steps on the Long Road to Self-Sufficiency for Indian Nations: The Indian Tribal Governmental Tax Status Act of 1982*, 22 HARV. J. ON LEGIS. 335 (1985). I am very much indebted to this article. Our emphases, however, are very different. Williams places these provisions in the context of Indian policy, while I consider them from the point of view of the legislative process. In addition, this article emphasizes developments subsequent to Williams's article.

2. See, e.g., *Iowa Mutual Ins. Co. v. LaPlante*, 480 U.S. 9, 14 (1987); *National Farmers Union Ins. Cos. v. Crow Tribe of Indians*, 471 U.S. 845 (1985); *Kerr-McGee Corp. v. Navajo Tribe of Indians*, 471 U.S. 195 (1985); *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 137 (1982).

3. See, e.g., *Oklahoma Tax Comm'n v. Sac & Fox Nation*, 113 S. Ct. 1985 (1993); *McClanahan v. Arizona State Tax Comm'n*, 411 U.S. 164 (1973). See generally Russell Lawrence Barsh, *Issues in Federal, State, and Tribal Taxation of Reservation Wealth: A Survey and Economic Critique*, 54 WASH. L. REV. 531 (1979) (considering effects of erosion of tribal taxing powers by state and federal court decisions).

4. Foreign governments are taxable on income received directly or indirectly from their conduct of commercial activities, but not on income received from stocks and bonds. I.R.C. § 892 (1988). Treasury regulations define commercial activities as "all activities . . . which are ordinarily conducted by the taxpayer or by other persons with a view towards the current or future production of income or gain." Temp. Treas. Reg. § 1.892-4T(b) (1988).

5. U.S. CONST. art. I, § 8, cl. 3.

6. "Congress has assumed nearly unfettered authority to govern Indian affairs." Philip P. Frickey, *Congressional Intent, Practical Reasoning, and the Dynamic Nature of Federal Indian Law*, 78 CAL. L. REV. 1137, 1138 (1990). See generally Robert T. Laurence, *The Indian Commerce Clause*, 23 ARIZ. L. REV. 203 (1981) (asserting Indian Commerce Clause is analogous, but not rigidly parallel, to Interstate Commerce Clause); Nell Jessup Newton, *Federal Power Over Indians: Its Sources, Scope, and Limitations*, 132 U. PA. L. REV. 195 (1984) (describing history of plenary power doctrine and arguing for heightened judicial scrutiny when Congress asserts such power).

7. See *United States v. Mitchell*, 463 U.S. 206, 225-28 (1983); *Delaware Tribal Business Comm'n v. Weeks*, 430 U.S. 73, 85 (1977); *Morton v. Mancari*, 417 U.S. 535, 555 (1974); see also, Nell Jessup Newton, *Enforcing the Federal-Indian Trust Relationship After Mitchell*, 31 CATH. U. L. REV. 635 (1982) (discussing breach of trust claims made by Indian tribes).

federal government has announced a policy of encouraging economic development and self-sufficiency for Indian tribes and tribal members.⁸ The myriad problems faced by tribal governments include an inadequate infrastructure, lack of access to capital, and an unskilled labor force.⁹ Congress may wish to use all available means, including tax incentives, to address such daunting problems.

Until the last decade, however, Congress did not recognize the sovereignty of tribal governments for purposes of federal taxation. It did not seek to discharge its fiduciary duty toward the tribes through tax preferences; neither did it assert a power to tax the Indian tribes as such. Instead, during this period IRS rulings governed taxation of tribal governments. These rulings exempted both tribal governments and their wholly owned corporations from federal income tax, but denied tribal governments other tax preferences afforded state and local governments. In 1982, without addressing the tax status of the tribes as such, Congress passed the Indian Tribal Governmental Tax Status Act, codified as section 7871 of the Internal Revenue Code, treating tribal governments as state governments for a variety of specified tax provisions.¹⁰

A key provision of this legislation permitted tribal governments, like state and local governments, to issue tax-exempt bonds.¹¹ The provision for tribal governments, however, limited bond offerings to those for "essential governmental functions,"¹² a restriction not applicable to bonds issued by state and local governments. In the case of the tribal bond provisions, concerns of one Congressman prompted language in the committee report that suggested, although it did not require, a narrow reading of this limitation. Regulations issued by the Treasury Department nonetheless adopted a lenient interpretation of the tribal bond provision, one permitting issuance of tax-exempt bonds for economic development through tribal enterprises.¹³

These regulations, which Indian tribal governments had urged, permitted a wide variety of projects, including business endeavors designed to generate revenue.¹⁴ Even under such a generous set of regulations, few tribal bond offerings took place. With one exception, all were leveraged buy-outs involving off-reservation businesses. In 1987, after media coverage of these offerings, Congress added statutory restrictions. Language in a committee report harshly condemned the regulations.¹⁵ For five years after revision of the statute, no major tribal bond offering came to market. Recently, isolated bond offerings have taken place.

This article details the circumstances surrounding passage of the bond provision,

8. See, e.g., Indian Gaming Regulatory Act, 25 U.S.C. § 2701(4) (1988) ("a principal goal of Federal Indian policy is to promote tribal economic development, tribal self-sufficiency, and strong tribal government").

9. See Williams, *supra* note 1, at 341-57, 336 n.3.

10. Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 100-203, ch. 80, 96 Stat. 2607 (1982) (codified at I.R.C. § 7871 (1993)) [hereinafter Tribal Tax Act].

11. Tribal Tax Act, *supra* note 10, § 202, 96 Stat. at 2608.

12. *Id.*

13. Treas. Reg. § 305.7871-1 (1984).

14. *Id.*

15. See *infra* note 168 and accompanying text.

the promulgation of regulations under the statute, the response of tribal governments to these new rules, and congressional dissatisfaction with the results. Depending upon the theories employed regarding congressional motivation, legislative history, and the exercise of administrative discretion, these same pieces of evidence tell very different stories. At one extreme, members of Congress may be seen as acting disinterestedly to guard the federal fisc, the IRS as being captured by tribal governments, and Congress as acting promptly to correct the IRS position. At the other extreme, members of Congress may be said to have acted from narrow self-interest and the IRS to have exercised independent judgment to promote the public interest, only to have subsequent congressional response capitulate to personal concerns of a single member of Congress.

Whichever story these facts are deemed to tell, they demonstrate a series of issues crucial to the workings of the legislative and administrative process. The first issue centers on the question of specificity in statutory language. While specific and unambiguous statutory language best ensures that the intent of the legislative coalition enacting the provision will be fulfilled, such clarity is often impossible. Sometimes the constantly evolving and changing nature of the problem prohibits specificity. Sometimes, as here, the ambiguity permits formation of a congressional coalition to support the legislation.

The second issue concerns the consequences of statutory ambiguity. The attempt to satisfy various factions of a legislative coalition may produce a statute with only symbolic value. Here, the desire of some members of Congress to recognize the sovereignty of tribal governments and the desire of others to protect against abuses of tax-exempt bonds served to cancel each other out. Congress accomplished neither goal instead of both.

Statutory ambiguity also expands the discretion of the agency administering the statute. A broad delegation of authority increases the possibility that the agency's decisions will deviate from the preferences of the legislative coalition that passed the provision. In this case, language in the committee report forces us to ask the extent to which legislative history should constrain the discretion of an administrative agency. Congressional action condemning the generous regulations suggests that members of the legislative coalition expect administrative agencies to craft regulations that follow legislative intent as expressed in legislative history.

The third issue involves the dynamics of the regulatory process. This case study demonstrates how the nature of the administrative process is likely to undermine directions in legislative history that an agency limit benefits for the targeted group. Administrative agencies, including the Treasury Department, rely on those it regulates for information and policy development. Such reliance is likely to produce, as it did here, regulations and rulings that favor the regulated party. As this study documents, even the Treasury Department may be overly generous to the regulated party. Leniency is especially likely when an agency promulgates rules under a statutory provision designed either to tax or to limit the tax benefits of a discrete, well-organized group with congruent needs and desires.

The fourth issue pertains to congressional monitoring of the regulatory process.

In an important pair of articles, McCubbins, Noll and Weingast have argued that notice and comment rulemaking, such as that employed here, relieves politicians from the need to monitor actively the administrative process.¹⁶ Instead, they explain, the policy's target group will monitor the administrative procedures and sound a "fire alarm" to trigger legislative response when the administrative agency contemplates action that departs from the legislative deal. This case study presents a significant constraint on this hypothesis. If the contemplated administrative action is more generous to the targeted group than some members of the original legislative coalition intended, no private party will sound an alarm. Those in Congress who fear lenient regulations will need to undertake formal or informal oversight themselves in order to avoid this result.

This article begins by reviewing the IRS rulings that preceded any legislative action. Part II explores the forces that produced the Tribal Tax Act of 1982 and analyzes the legislative benefits of the vague statutory standard. Part III describes the response of the IRS to the statute. It explains the impact of the tribal governments on the regulatory process and the significance of such participation on administrative discretion. Part IV considers the bond offerings undertaken by the tribes, the congressional action to halt such offerings, and the consequences of the legislative changes. The article concludes by observing that, however one evaluates the result in the tribal bond case, this series of events demonstrates the need for active oversight by members of Congress who wish both to prevent lenient regulations under broad statutory delegations and to avoid costly ex post action, such as passing new legislation.

I. Background: IRS Rulings

Prior to the Tribal Tax Act of 1982, the IRS determined the tax treatment of Indian tribal governments. A key ruling, Revenue Ruling 67-284¹⁷ declared baldly: "Income tax statutes do not tax Indian tribes. The tribe is not a taxable entity."¹⁸ The ruling gave no analysis or basis for this conclusion. It cited no statutory authority. Indeed, the ruling dealt primarily with federal income tax treatment of income paid to or on behalf of enrolled members of Indian tribes.¹⁹ The two sentences regarding the taxable status of the tribe itself came as an aside.

No explicit policy analysis supported the IRS conclusion regarding the exemption of Indian tribes. Without indicating what kind of entity a tribal government was, the IRS determined it was not a taxable entity. The conclusion that tribal

16. Matthew D. McCubbins et al., *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431 (1989) [hereinafter McCubbins et al., *Structure and Process*]; Matthew D. McCubbins et al., *Administrative Procedures as Instruments of Political Control*, 3 J.L. ECON. & ORGANIZATION 242 (1987) [hereinafter McCubbins et al., *Administrative Procedures*].

17. 1967-2 C.B. 55.

18. *Id.* at 58.

19. The ruling concludes that income of individual tribal members is exempt only if protected by a special treaty or federal statutory provision, or if "derived directly by a noncompetent Indian from allotted and restricted land held under the General Allotment Act." *Id.* at 56.

income is exempt represents a literal reading of, rather than a policy-motivated approach to, the Internal Revenue Code. Revenue Ruling 67-284, unlike the subsequent legislation, did not draw parallels between tribal governments and state or local governments.

Revenue rulings both before and after Revenue Ruling 67-284 applied this literal reading of the Code provisions. They declined to treat Indian tribes as states or political subdivisions, notwithstanding any similarities between them. Thus, the IRS failed to extend to Indian tribes a variety of tax preferences permitted state and local governments.²⁰ Revenue Ruling 68-231,²¹ for example, concluded that interest on the debt obligations of a tribal government was not eligible for the exclusion from income tax provided by section 103 of the Internal Revenue Code for interest paid on an obligation of a state or political subdivision thereof.²² There the IRS explained: "The Tribe is not a division of the State, and since it exercises its governing powers by virtue of Federal, rather than State authority, the bonds in question are not issued on behalf of the State within the meaning of the regulations [under section 103(a)]."²³

The IRS applied a policy analysis to the tax treatment of Indian tribes in only one ruling. Revenue Ruling 81-295²⁴ concluded that a federally chartered Indian tribal corporation was not taxable on income derived from the corporation's income-producing activities, including a catfish hatchery and an annual tribal fair. The tribe had incorporated itself pursuant to section 16 of the Indian Reorganization Act of 1934.²⁵

According to the Senate Report, tribal incorporation was permitted in order for "Indian tribes to equip themselves with the devices of modern business organi-

20. Revenue Ruling 58-610, 1958-2 C.B. 815, for example, denied an Indian tribe the exemption from excise taxes on the sale of automobiles available to political subdivisions or agencies of a state. Similarly, Revenue Ruling 74-179, 1974-1 C.B. 279, refused to allow a charitable deduction for a bequest by a decedent's estate to the Zuni Indian Pueblo.

21. 1968-1 C.B. 48.

22. See I.R.C. § 103(c)(1) (1988). The ability to issue tax-exempt bonds reduces the cost of capital for state and local governments. In 1982, for example, the year the Tribal Tax Act was passed, the tax-exempt yield for Aa-rated bonds was 11.31 percent and the corporate yield for bonds of equivalent risk was 14.41 percent, a savings of 3.1 percentage points in interest costs. In 1989, the average tax-exempt yield was 7.16 and the corporate yield 9.57, a differential of 2.41 percentage points. DENNIS ZIMMERMAN, *THE PRIVATE USE OF TAX EXEMPT BONDS: CONTROLLING PUBLIC SUBSIDY OF PRIVATE ACTIVITY* 59 (1991). See *infra* notes 47-49 and accompanying text for a discussion of types of tax-exempt bonds.

23. Rev. Rul. 68-231, 1968-1 C.B. 48, 49-50.

24. 1981-2 C.B. 15.

25. 25 U.S.C. § 476(a) (1988). The Indian Reorganization Act, which permitted a tribe to adopt a constitution and by-laws "for its common welfare," also authorized the Secretary of Interior to issue a corporate charter for "the conduct of corporate business." *Id.* § 477. The Act is also known as the Wheeler-Howard Act, which, Senator Wheeler explained, sought to

get away from the bureaucratic control of the Indian Department, and . . . further to give the Indians the control of their own affairs and of their own property; to put it in the hand either of an Indian council or in the hands of a corporation to be organized by the Indians.

78 CONG. REC. 11,125 (1934). It has been described as "one of the most significant single pieces of legislation directly affecting Indians ever enacted by the Congress of the United States." Comment, *Tribal Self-Government and the Indian Reorganization Act of 1934*, 70 MICH. L. REV. 955, 955 (1972).

zation, through forming themselves into business corporations."²⁶ Each tribe, however, could form only one such federally chartered corporation.²⁷ The 1934 Indian Reorganization Act did not explicitly address tribal immunity from state or federal taxation.²⁸ A literal reading of the Code would tax such tribal corporations under the provisions applicable to corporations in general. Revenue Ruling 81-295, however, concluded that the tribal corporation was coextensive with the tribe itself and that the federally chartered Indian tribal corporation shared the exempt tax status of the Indian tribe for income earned on the reservation.²⁹ The ruling treats the Indian corporations much like municipal corporations, which the IRS has categorized as exempt political subdivisions rather than taxable corporations.³⁰

Revenue Ruling 81-295 addressed only activities carried on within the boundaries of the reservation. It imposed this limitation in reliance on the Supreme Court's decision in *Mescalero Apache Tribe v. Jones*.³¹ *Mescalero Apache Tribe* held that the tribe was subject to a state gross receipts tax on income earned from a ski resort operated by the tribe off-reservation. The case, however, distinguished between on- and off-reservation activities precisely because the subject matter involved state taxes.³² The same distinction need not have any relevance to the tribe's activities for purposes of federal taxation. Nonetheless, the Revenue Ruling adopted it without discussion.

Revenue Ruling 81-295 also looked to a footnote in *Mescalero Apache Tribe* stating that "the question of tax immunity cannot be made to turn on the particular form in which the Tribe chooses to conduct its business."³³ The IRS quoted the Supreme Court footnote out of context in Revenue Ruling 81-295,³⁴ and the

26. S. REP. NO. 1080, 73d Cong., 2d Sess. 1 (1934).

27. "The Secretary of Interior may, upon petition by at least one-third of the adult Indians, issue a charter of incorporation to such tribe. . . . Any charter so issued shall not be revoked or surrendered except by Act of Congress." 25 U.S.C. § 477 (1988).

28. In contrast, when Congress established a series of Native Alaskan corporations as part of the Alaska Native Claims Settlement Act, it specified that income from the investment of revenues would be taxable. See 43 U.S.C. § 1620(a) (1988).

29. Rev. Rul. 81-295, 1981-2 C.B. 15. The ruling acknowledged that there was no constitutional or statutory authority exempting tribes from taxation, but explained, "the political entity embodied in the concept of an Indian tribe has been recognized and no tax liability has been asserted against a tribe with respect to tribal income from activities carried on within the boundaries of the reservation." *Id.* at 16.

30. See Gen. Couns. Mem. 14,407 (Jan. 28, 1935). For a discussion of the basis for such exemption, see Ellen P. Aprill, *Excluding the Income of State and Local Governments: The Need for Congressional Action*, 26 GA. L. REV. 421, 430-34 (1992).

31. 411 U.S. 145 (1973).

32. As the Supreme Court noted, "Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State." *Id.* at 148-49. That is, because of tribal governments' sovereign status, states have no jurisdiction to tax them within the reservation. It is crucial that the activity be off-reservation for the states to tax. Federal authority does not depend on this distinction.

33. *Id.* at 157 n.13.

34. In context, this language had a limited thrust. The Supreme Court footnote explained that the record did not show whether the Mescalero Apache Tribe was incorporated under the Indian Reorganization Act, but that in any case the tribal constitution gave the council power to conduct such enterprises. That is, the footnote emphasized that, for purposes of state taxation, the off-reservation activity was taxable, whether conducted directly by the tribe itself or by the tribal corporation. *Id.*

quoted language developed a life of its own in subsequent IRS private letter rulings. Relying heavily on Revenue Ruling 81-295 and the footnote in *Mescalero Apache Tribe*, a series of private rulings held that any state-chartered, for-profit corporation wholly owned by an Indian tribe is exempt from tax on income from on-reservation activities.³⁵ Such for-profit state corporations, however, are not co-extensive with the tribe in the same way as the tribe's federally chartered corporation. Tribes can form many state-chartered, for-profit corporations. The IRS has recently recognized these important distinctions. Revenue Ruling 94-16³⁶ held that, while federally incorporated tribal corporations are not subject to federal income tax on the income earned on or off the reservation, tribal corporations organized under state law will be subject to federal income tax on any income earned, regardless of the location of the business activities.³⁷

Neither the Indian Tribal Governmental Tax Status Act of 1982³⁸ (the Tribal Tax Act) nor its subsequent amendments, however, explicitly address the taxation of the tribal governments or their wholly owned corporations.³⁹ As discussed below, the legislative history of the Tribal Tax Act acknowledged Revenue Ruling 67-284, the IRS interpretation exempting the tribal governments from taxation. The legislation itself, however, concerned only the tax benefits denied in various IRS rulings, such as the ability to issue tax-exempt bonds. The tax-exempt status of income generated by the tribal governments and their wholly owned corporations thus remains a matter of administrative ruling and administrative discretion. Revenue Ruling 94-16 now distinguishes between income earned by federal and state corporations;⁴⁰ Revenue Ruling 81-295 distinguished between income earned on and off the reservation.⁴¹ Congressional failure to address the tax status of tribal income represents a serious weakness of the Tribal Tax Act.⁴²

35. See Priv. Ltr. Rul. 91-22-072 (Mar. 6, 1991) (tribal corporation formed to manage mine site reclamation); Priv. Ltr. Rul. 89-37-036 (June 20, 1989) (corporation owned by tribe conducted manufacturing business); Priv. Ltr. Rul. 88-03-013 (Oct. 19, 1987) (tribal corporation organized to increase industrial development by gaining defense contracts through Small Business Association program); Priv. Ltr. Rul. 88-02-017 (Oct. 9, 1987) (corporation owned by tribe organized to own and manage properties and to conduct business as development liaison between tribe and private enterprise).

36. 1994-12 I.R.B. 1.

37. *Id.*

38. Tribal Tax Act, *supra* note 10.

39. Only one provision of the Internal Revenue Code explicitly addresses the tax status of certain tribal income. Section 7873, enacted in 1988, exempts from tax income derived from certain fishing rights by a qualified Indian entity, including a tribe, or by a member of an Indian tribe. I.R.C. § 7873 (1988). The statutory provision regarding taxation of the tribe's income from fishing rights appears gratuitous, in light of Rev. Rul. 67-284. There is no indication that section 7873 intended to overrule the revenue ruling and tax all other tribal income.

40. Rev. Rul. 94-16, *supra* note 36.

41. Rev. Rul. 81-295, *supra* note 29, at 16.

42. Recent developments make this weakness particularly serious. Revenues from gambling operations authorized under the Indian Gaming Regulatory Act have proven lucrative for many Indian tribes. Under the Gaming Act, Indian tribes can negotiate compacts with the states in which they are located to conduct casino-type operations. See Indian Gaming Regulatory Act, 18 U.S.C. §§ 1166-68, 25 U.S.C. §§ 2701-21 (1988). Federal officials have stated that tribes earn approximately \$500 million per year from gaming. Karen Pierog, *Indian Tribes Come Back to Muni Market with Big Revenues from Casino Gambling*, BOND BUYER, Aug. 27, 1992, at 1. Other estimates put annual gross

II. Congressional Action 1975 to 1982

A. LEGISLATIVE PROPOSALS

Legislation giving Indian tribes a tax status similar to that granted to state and local governments for certain specified purposes was first introduced in 1975 as House Bill 8989.⁴³ The proposed legislation applied to a variety of tax provisions, including deductibility of property taxes, eligibility for charitable contribution deductions, and exemption from excise taxes.⁴⁴

Among the most important provisions of the legislation was the one authorizing tribes to issue bonds with tax-exempt interest.⁴⁵ The ability to sell tax-exempt bonds under section 103 of the Internal Revenue Code significantly reduces the cost of capital for governmental entities.⁴⁶ Under section 103, state and local governments generally issue two types of bonds, general obligation bonds and

gaming revenue in excess of \$1 billion since 1988, Ellen Perlman, *Pushing for States Rights: Proposals Seek Restrictions on Indian Gaming*, Crain Comm., Inc., June 7, 1993, at 4 (available in LEXIS, NEXIS Library, News File) and close to \$6 billion in 1992, Martin Walker, *Trump on Indian Warpath*, GUARDIAN, May 8, 1993, at 15. These revenues heighten the need for statutory guidance. See William L. Raby, *They Can't Take That Away from Me? Indian Tribes and Their Income Tax "Exemption,"* 55 TAX NOTES 1513, 1515 (1992) ("If the profits from Indian-operated casino gambling become sufficiently large, they may tempt the tax collector to reexamine the rationale for exempting tribal income in the first place. . . . It would not be the first time that Washington has tried to take something away from the Indians."). The IRS has recently released a draft copy of its "Guide to Indian Taxation Issues," designed to address tax questions related to gambling income as well as other issues. See Harriet Hanlon, *IRS and Tribal Representative Discuss Draft Copy of Guide To Indian Taxation Issues*, 94 TAX NOTES TODAY 43-5 (Mar. 4, 1994).

43. H.R. 8989, 94th Cong., 1st Sess. (1975). Representative Ullman, Chairman of the Ways and Means Committee, introduced the bill. 121 CONG. REC. H25,304 (July 28, 1975). It was sponsored as well by Representative Udall, Chairman of the Interior Committee. 127 CONG. REC. S11,132-33 (June 2, 1981). The committee which Ullman chaired had jurisdiction over the Bureau of Indian Affairs. See 121 CONG. REC. H25,304 (1975). The House Ways and Means Committee reported H.R. 8989 favorably, but the full House did not consider it in the 94th Congress. See H.R. REP. NO. 1693, 94th Cong., 2d Sess. 1 (1976); Williams, *supra* note 1, at 364, 364-65 n.134. The Indian Tribal Governmental Tax Status Act was reintroduced in the House of Representatives during the 95th Congress as H.R. 4089, which was identical to the version of H.R. 8989 reported out of the House Ways and Means Committee during the 94th Congress. See H.R. 4089, 95th Cong., 1st Sess. *reprinted in* 123 CONG. REC. H5,372 (1977); Williams, *supra* note 1, at 365 n.335.

One analyst of Indian legislation places the tax legislation in the context of a series of pro-Indian bills passed in the 1970s and early 1980s. Such legislation included the Indian Education Act, Pub. L. No. 92-318, 86 Stat. 334 (1972), the Indian Financing Act of 1974, Pub. L. No. 93-262, 88 Stat. 77 (1974), the Indian Self-Determination and Educational Assistance Act, Pub. L. No. 93-638, 88 Stat. 2203 (1975) and the creation of the American Indian Policy Review Commission. The analyst attributes this spurt of pro-Indian legislation to a variety of factors, including the influence of the civil rights legislation of the 1960s, reaction to the failure of the 1960s policy terminating tribes, and President Nixon's support for Indian self-determination. The approach of much of this legislation was to recognize tribal sovereignty and rights to self-determination by treating the tribal governments like state and local governments. See EMMA R. GROSS, *CONTEMPORARY FEDERAL POLICY TOWARD AMERICAN INDIANS* 71-72 (1989).

44. H.R. 8989, 94th Cong., 1st Sess., §§ 7, 8, 13, 14 (1976).

45. *Id.* § 5.

46. See *supra* note 22. Tax-exempt bonds, along with federal grants-in-aid and the deductibility of state and local taxes, also function as a key form of intergovernmental assistance: "[W]hen the substantial price increases that occurred during the decade are taken into account, bonds represent the only source of intergovernmental assistance that experienced positive real growth,

revenue bonds.⁴⁷ General obligation bonds are backed by the full faith and credit of the issuing government. Such bonds have an unconditional pledge of the issuing government that it will use its powers of taxation to repay both principal and interest. Investors look to the government's taxing power as security for repayment. Governmental units with full taxing powers, such as states or cities, issue general obligation bonds. Revenue bonds, in contrast, pledge only the earnings from revenue-producing activities, most often the earnings from the facilities being financed. Revenue bonds are frequently issued by special districts, such as sewer districts, or by dependent agencies created by state and local governments. Revenue bonds also include industrial development bonds or private activity bonds (PABs),⁴⁸ which the governmental unit issues for use by or on behalf of private businesses.⁴⁹ For example, a sewer district would issue PABs to build a sewage plant that will then be privately managed.

State and local governments frequently turn to tax-exempt PABs as a tool for economic development.⁵⁰ At the time the tribal tax legislation was first introduced, state and local governments faced relatively few restrictions when issuing tax-exempt PABs. In the late 1970s and early 1980s, a bond issued by a state or local government was considered a taxable PAB if more than 25 percent of the proceeds was used by a private party in a trade or business and debt service on more than 25 percent of the proceeds was secured by (or derived from payments in respect to) property used in a trade or business.⁵¹ A long list of activities, however, was exempted from these PAB restrictions, including parking facilities, docks, wharves, airports, sports facilities, and air or water pollution controls.⁵² In addition, there was a "small issue" PAB exception under which any PAB issue of \$1 million or less was not taxable if the proceeds were used for the acquisition,

a very substantial 82.5 percent. In contrast, grants-in-aid and deductibility both suffered negative real growth of 9.4 and 9.3 percent, respectively." ZIMMERMAN, *supra* note 22, at 88. Under the Congressional Budget Act of 1974, many tax incentives, known as tax expenditures, are deemed to be a governmental spending program in the guise of a tax provision and must be listed in a special analysis as part of the budget process. See 2 U.S.C. § 639(c)(3) (1988). The exclusion of interest on certain municipal bonds figures prominently on the list of tax expenditures. The Fiscal Year 1993 Budget of the United States listed the exclusion of interest on governmental debt eleventh on the list of major tax expenditures ranked by revenue loss and estimated the 1993 revenue loss at over \$11 billion. EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT & BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1993, Pt. 2, at 39 (1993). The 1993 Budget further estimated exclusion of interest on private activity bonds (PABs) at over \$3 billion for fiscal year 1993. *Id.*

47. This description is based on ZIMMERMAN, *supra* note 22, at 55-56.

48. At the time of the Tribal Tax Act, such privately used tax-exempt bonds were known as industrial development bonds or "IDBs." See I.R.C. § 103(b) (1982). Since the Tax Reform Act of 1986, the Code has called these bonds "private activity bonds." See I.R.C. §§ 141-147 (1987). I will use the term PAB for bonds issued by a governmental entity to benefit a private party. Such PABs, if within the statutory exceptions, will be tax-exempt.

49. See ZIMMERMAN, *supra* note 22, at 90.

50. "IDB proponents, such as state economic development authorities, credit IDBs with creating jobs, assisting start-up companies, helping economically distressed areas, and keeping companies from moving operations to foreign countries." U.S. GEN. ACCOUNTING OFFICE, INDUSTRIAL DEVELOPMENT BONDS: ACHIEVEMENT OF PUBLIC BENEFITS IS UNCLEAR 4 (1993) [hereinafter GAO REPORT].

51. ZIMMERMAN, *supra* note 22, at 179-86.

52. *Id.* at 181.

construction, or improvement of land or depreciable property.⁵³ Under these exemptions, state or local governments could issue PABs, the proceeds of which benefitted private parties, that were nonetheless tax-exempt. State and local governments did so with relish,⁵⁴ using the tax-exempt PABs to encourage business.

The tribal tax legislation as originally proposed permitted tribal governments to issue tax exempt bonds for governmental functions. It limited, but did not prohibit, the ability of tribes to issue exempt bonds for commercial or industrial activity, either for the benefit of the tribe itself or for the benefit of private parties.⁵⁵ When hearings were held on this legislation, tribal witnesses testified repeatedly about the importance of tax-exempt financing to economic development, stating that the provision "could be the first step towards the long sought realization by Indian tribes of the chance for economic independence."⁵⁶ They also urged deletion of a section in the bill that limited the ability of tribal governments to issue PABs.⁵⁷

53. *Id.* In some situations, this \$1 million could be increased to \$10 million. See I.R.C. § 103(b)(6)(D) (1979).

54. "By 1984, private-activity bond share of new issue long-term bond volume was 72.7 percent." ZIMMERMAN, *supra* note 22, at 92.

55. H. R. 8989, *supra* note 44, § 5. As considered by the House Ways and Means Committee, the bill denied tax-exemption for interest on a tribal PAB if the proceeds were "used in any trade or business carried on outside the area reserved by Federal statute or treaty to the Indian tribe issuing the bond." *Id.* The House Ways and Means Committee amended the provisions relating to PABs. Under the amended version, interest on tribal PABs would still be exempt even if the activities supported by the bond proceeds were carried on outside of the reservations if substantially all of those activities related to "purchasing, marketing, or similar activities directly related" to the reservation PAB-financed trade or business. Interest, however, would not have been exempt for tribal obligations, other than a PAB, if all or a major portion of the proceeds were to be used directly or indirectly in an industrial or commercial activity. H.R. REP. NO. 1693, 94th Cong., 2d Sess. 2-3 (1976); see also Williams, *supra* note 1, at 362-65 (discussing legislative development of Indian tax status).

56. *Miscellaneous Minor Tax Bills, Second Hearing, 1976: Public Hearing Before the House Comm. on Ways and Means, 94th Cong., 2d Sess. 36 (1976)* (statement of Richard Anthony Baenen on behalf of the Confederated Salish and Kootenai Tribes of the Flathead Reservation, the Three Affiliated Tribes of the Fort Berthold Reservation, the Hoopa Tribe of the Hoopa Valley Reservation, and the Arapahoe Tribe of the Wind River Reservation); *id.* (mailgram of Luch Covington, Chairperson, Colville Business Council); *id.* at 43 (mailgram of Small Tribes Organization). Tribal leaders expressed similar sentiments during the 1982 hearings before the Senate. See *1981-82 Miscellaneous Tax Bills, XVI, Hearing Before the Subcomm. on Taxation and Debt Management of the Senate Finance Comm. on S. 1298, S. 2197, and S. 2498, 97th Cong., 2d Sess. 131 (1982)* (statement of Darrell Wadena, President, Minnesota Chippewa Tribe); *id.* at 141 (statement of Malcom P. Dalton, General Manager, Navajo Tribal Utility Authority); *id.* at 144 (statement of Robert Shorty, Jr., Chairman, Navajo Tax Commission).

57. See *Hearings Before the Subcomm. on Miscellaneous Revenue Measures, of the House Comm. on Ways and Means, 95th Cong., 1st Sess. 114 (1977)* (statement of Owen M. Panner on behalf of the Confederated Tribes of the Warm Springs Reservation of Oregon) (urging deletion of section 4(a)(2), which made interest on some bond issues taxable); *id.* at 116 (statement of Robert L. Pirtle, General Counsel, Colville Confederated Tribes) (stating that only if interest on tribal bond issues is tax-free will tribes have real opportunity to obtain capital); *id.* at 118 (statement of Ernest Clark, Chairman of the Finance Committee, Colville Confederated Tribes) (expressing same argument that the tribes' only real opportunity to obtain capital would be through use of tax-free bonds); *id.* at 122 (statement of R. Anthony Rogers, Legal Counsel for the National Congress of American Indians) (interpreting section 4(a)(2) as limiting, but not foreclosing tribal PAB issues); *id.* at 123 (statement of Robert Shorty, Jr., Chairman, Navajo Tax Commission) (asserting that tribal governments would like same finance opportunities as other governments).

The House Ways and Means Committee reported this legislation favorably, but the full House did not consider it.⁵⁸ No significant further legislative action took place until 1981. At that time, the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance held hearings on a version of tribal tax legislation identical to that introduced in 1975.⁵⁹

Like earlier versions of the legislation, the Senate bill gave tribal governments the same benefits as state and local governments for purposes of excise taxes, deductions for taxes paid, and income, estate and gift tax deductions.⁶⁰ As with earlier versions of the tribal tax legislation, the Senate bill permitted tribal governments to issue tax-exempt bonds, but imposed limits with respect to commercial or industrial activities. Under the bill, if the tribal government used all or a major portion of the proceeds in commercial or industrial activities that were not essential governmental functions, the interest on the bonds would not be tax-exempt.⁶¹ The Senate bill also allowed the tribe to issue tax-exempt PABs to benefit private parties. Such PABs were subject not only to the usual rules applicable to PABs, but also to the requirements that the principal activity of the trade or business be carried on within the reservation and that any off-reservation activities be limited to purchasing, marketing, or similar activities directly related to on-reservation activities.⁶²

The Senate Finance Committee Report recognized the basic federal income tax exemption of Indian tribes under Revenue Ruling 67-284. The report stated that the bill did not amend this treatment.⁶³ It explained that the purpose of the

58. See H.R. REP. NO. 1693, 94th Cong., 2d Sess. 1 (1976); Williams, *supra* note 1, at 364, 364-65 n.134.

For an overview of the tax legislative process, see 4 BORIS I. BITTNER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES & GIFTS* § 116.1 (2d ed. 1981); Bradford L. Ferguson et al., *Reexamining the Nature and Role of Tax Legislative History in Light of the Changing Realities of the Process*, 67 TAXES 804, 808-12 (1989); Michael Livingston, *Congress, the Courts, and the Code: Legislative History and the Interpretation of Tax Statutes*, 69 TEX. L. REV. 819, 832-44 (1992); JOSEPH A. PECHMAN, *FEDERAL TAX POLICY* 38-62 (5th ed. 1987). For purposes of this analysis, it is particularly important to note the key roles played by the House Ways and Means Committee and the Senate Finance Committee in setting the agenda for tax legislation, and by the professional staffs of the Joint Committee on Taxation and the Treasury Department's Office of Tax Policy in drafting the language of both the statutes and the legislative history. Once legislation is passed, staff in the Treasury Department and at the IRS draft the regulations. The author served as an attorney-advisor in the Treasury Department's Office of Tax Legislative Counsel in the Office of Tax Policy from 1987-89. Her responsibilities did not include either tribal governments or tax-exempt bonds.

59. S. 1298, 97th Cong., 1st Sess. (1982). The Senators sponsoring the bill included Malcolm Wallop (R-Wy), Bill Bradley (D-N.J.), Mark O. Hatfield (R-Ore.), Bob Packwood (R-Ore.) and Max Baucus (D-Mont). *Id.* at 1.

60. Other provisions included eligibility for certain tax-deferred annuities and an income tax credit for political campaign contributions. See Williams, *supra* note 1, at 369-70 n.155.

61. See S. REP. NO. 646, 97th Cong., 2d Sess. 14 (1982). In forbidding tax-exemption for bonds used to finance industrial or commercial activities that were not essential governmental functions, the Senate bill indicated that the choice of the tribal government to engage in a particular industrial or commercial activity did not alone render the activity an essential governmental function. S. 1298, 97th Cong., 1st Sess. § 3 (1981).

62. *Id.* at 14-15. The bill also included a new rule for applying the dollar limits for small-issue PABs. *Id.*

63. *Id.* at 12.

tribal bond restrictions was to permit either the profits to be exempt or the interest on the obligations to be exempt, "but not to allow both of these income tax benefits to apply in any one case."⁶⁴

B. BONDING AUTHORITY UNDER THE TRIBAL TAX ACT

The Senate incorporated its tribal tax legislation into House Bill 5470, the Periodic Payment Settlement Act.⁶⁵ The House had not included tribal tax legislation in its version of this Act. A conference was called.⁶⁶ The conference agreement made significant changes to the provisions regarding tax-exempt financing,⁶⁷ and the version resulting from the conference agreement, which became law, prohibited tribal governments from issuing any "private activity bond."⁶⁸ That is, unlike their authority under any earlier version of the legislation, tribal governments could not issue PABs under the conference agreement.⁶⁹ Moreover, this legislation authorized Indian tribal governments to issue tax-exempt bonds "only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function."⁷⁰

The Conference Committee Report⁷¹ explained that "essential governmental functions" include projects such as "schools, streets, and sewers."⁷² It reiterated that tribal governments were forbidden from issuing private activity bonds, including industrial development bonds.⁷³ The Report implied that the definition of essential governmental function should be limited to the most traditional of governmental functions by referring specifically to schools, streets, and sewers. Nonetheless, the legislative history, by doing no more than listing examples, did not define precisely or indicate clearly the scope of the term.

64. *Id.* at 14. The Senate report failed to acknowledge (or perhaps to realize) that states are allowed both benefits. The Senate report cites Internal Revenue Code § 115, which exempts only essential governmental activities, as the basis for exempting state and local government from federal income tax. *Id.* at 8. In fact, the IRS does not rely generally on § 115 to exclude the income of state and local governments. It finds instead that no provision of the Internal Revenue Code taxes governments or their integral parts. Thus, income from activities conducted directly by a state is exempt, whether or not the activity is an essential governmental function. The IRS applies § 115 only if an entity is incorporated separately from the government. See Aprill, *supra* note 30, at 430-34.

65. See S. REP. NO. 646, *supra* note 61, at 1.

66. 128 CONG. REC. S31,513 (1982).

67. There were almost no changes to other provisions.

68. H.R. CONF. REP. NO. 984, 97th Cong., 2d Sess. 16-17 (1982) *reprinted in* 1982 U.S.C.C.A.N. 4598, 4602.

69. Williams notes that no "witness or member of the Senate or House, in printed hearings, committee reports, or debate, ever voiced objection to the principle of providing Indian tribes a tax status similar to states and local governments with respect to IDB financing." Williams, *supra* note 1, at 368 n.149.

70. Tribal Tax Act, *supra* note 10, § 202(a), I.R.C. § 7871(c)(1) (1988). The conference accepted the Senate version of other provisions. The Tribal Tax Act as passed included a sunset provision limiting certain benefits, including tax-exempt bond authority, to years before January 1, 1985. Tribal Tax Act, *supra* note 10, § 204, 96 Stat. at 2611. An amendment to the Tribal Tax Act passed by Congress in July 1984 eliminated the sunset provisions. Tax Reform Act of 1984, Pub. L. No. 98-369, § 1065(a), 98 Stat. 494, 1048 (1984).

71. H.R. REP. NO. 984, 97th Cong., 2d Sess. 16-17 (1982).

72. *Id.* at 17.

73. *Id.*

These changes to the bond provisions responded largely to concerns of Representative Gibbons, a member of the Ways and Means Committee and one of the conferees for the Tribal Tax Act, based on his personal experiences.⁷⁴ Not long before consideration of the Tribal Tax Act, Representative Gibbons had joined other federal and state officials in supporting the transfer of land outside Tampa, Florida, into a federal trust for the benefit of the Seminoles.⁷⁵ In 1979, during excavation for a planned city parking garage in Tampa, archaeologists had unearthed bones of 140 Indians buried on the site. The discovery threatened to bring the parking lot project to a halt. The Seminoles offered to remove their ancestors' bones and inter the remains elsewhere in a sacred shrine, if they could obtain land to do so. City and state officials accepted the offer, and federal officials helped the tribe obtain land for this purpose. During negotiations for the land, the Seminole chairman explained that he intended to do some economic development on the site as well.

After the land was obtained, the tribe interred the bones and built a museum above the tomb. To the surprise of federal and state officials, it also built a cigarette shop and a 1,400-seat bingo hall. Incensed federal officials accused the tribe of hiding its true intentions about the use of the land. Several months before the land was purchased by the tribe and put in trust, the Seminoles, unbeknownst to government officials, had signed a development contract with a partnership that loaned the tribe money to buy the land. The management contract later executed with the partnership was "particularly lucrative, giving it 47% of the bingo and cigarette profits for 12 years."⁷⁶

This experience prepared Representative Gibbons to object to the tribal bond provision in the Senate bill. His particular concern was understood to be bingo parlors.⁷⁷ Such a concern may have a variety of bases. Large-scale tribal bingo, like other gambling, might attract criminal elements.⁷⁸ Large-scale tribal bingo could also compete with established bingo games, and many tax-exempt organizations, including churches and other charities, conduct bingo games to raise funds.⁷⁹ Representative Gibbons and the others who supported narrowing the tribal bond provision also may have feared that tribal bonds would be used for economic development projects designed to produce profit for private promoters. Either out

74. See Williams, *supra* note 1, at 368 n.146.

75. This description is based on John MacCormack, *New Riches Grow from Old Burial Ground*, MIAMI HERALD, May 31, 1983, at 6A. The account contained in the newspaper story is consistent with the version told to the author by several participants in the tribal bond saga.

76. *Id.*

77. See Williams, *supra* note 1, at 368 n.146. Others have expressed a similar belief to the author. Whether or not true, this explanation has come to be accepted and believed. As one author writes, after telling this story without naming the tribe or the representative, "[t]he member's disillusionment with his Indian constituency is supposed to be the reason that he currently opposes Indian interests." GROSS, *supra* note 43, at 84.

78. Such is an expressed concern about tribal casinos. See Pam Greenberg & Judy Zelio, *States and the Indian Gaming Regulatory Act*, STATE LEGIS. REP., July 1992, at 1 (on file with author).

79. Under I.R.C. § 513(f) charities may conduct bingo free of federal income tax. I.R.C. § 513(f) (1988).

of paternalism or prejudice, they may have worried that unscrupulous promoters would take advantage of unsophisticated tribal officials.

The prohibition of tribal PABs that emerged during Conference, however, suggests that the House members of the Conference Committee more generally feared "rent seeking"—the transfer of public resources to private parties through the political process.⁸⁰ With little public participation or awareness, PABs allow elected officials at the state or local level to pass the indirect federal subsidy of tax exemption to selected private businesses.⁸¹ Indeed, Congress was tightening the general rules regarding PABs at the same time it was considering the Tribal Tax Act, and Representative Gibbons supported these restrictions.⁸² Moreover, PABs, especially small-issue PABs, have been issued for questionable uses, such as massage parlors, pornographic bookstores, liquor stores and outlets of national retailers.⁸³ Furthermore, studies of PABs do not support the claims that they succeed in creating jobs, assist economically distressed areas, or foster start-up companies.⁸⁴

If the cost of PABs exceeds their benefits, there is little reason to expand this bonding authority to yet more entities, such as tribal governments. Of course, if PABs are not cost-effective, there is little reason to permit any governmental entity to issue PABs. Congress, however, limited rather than eliminated the authority of state and local governments to issue PABs. The political power of state and local governments made repeal of PAB authority impossible. Tribal governments did not possess similar political power and were unable to prevent the congressional prohibition of tribal PABs.⁸⁵

80. See Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 41 (1990); Robert D. Tollison, *Rent Seeking: A Survey*, 35 KYKLOS 575, 575 (1982).

81. See ZIMMERMAN, *supra* note 22, at 169-70 (stating "[p]olitical support is likely to follow if . . . groups can be given access to low-cost capital through the effort of the elected official.").

82. See Gretchen Chell, *House Seen Considering Adding Curbs on IDBs to Reagan Tax Cut Bill*, BOND BUYER, Mar. 31, 1981, at 1. Congress imposed new limits on the ability of state and local governments to issue tax-exempt bonds, particularly PABs under the small issue exemption, by tightening restrictions on the dollar amounts and types of facilities financed by PABs. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, §§ 214-21, 96 Stat. 324, 466-78 (codified as amendments to I.R.C. § 103). These new rules reflected congressional concern about "the volume of tax-exempt bonds used for private activities" and "the distortions in the allocation of scarce capital resources" caused by the "availability of tax-exempt financing" so that "allocation of capital investments is based upon government decisions rather than their relative economic productivity." JOINT COMM. ON TAXATION, GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 98-99 (Comm. Print 1982). In 1985, Representative Gibbons offered an amendment to eliminate small-issue PABs. Howard Gleckman, *Ways and Means Votes to End One-Third of Private-Use Bonds*, BOND BUYER, Oct. 28, 1985, at 1.

83. See Chell, *supra* note 82, at 1; Arthur J. Kalita, *States, Localities Must Take a Stand Against Overreaching IRB Restrictions*, BOND BUYER, May 7, 1982, at 5; Louis J. Mell, *Proposed Bond Issues*, BOND BUYER, Jan. 21, 1983, at 4.

84. See GAO REPORT, *supra* note 50, at 17-20. ZIMMERMAN, *supra* note 22, at 170, concludes that PABs do not increase net investment and employment, but simply reallocate benefits among activities and redistribute them geographically.

85. Moreover, tribal PABs would have put tribal governments in the position of competing with state and local governments to attract businesses, as municipalities currently compete with each other to attract business.

The Tribal Tax Act did permit tribes to issue public activity bonds for essential governmental functions. Yet, many traditional governmental functions, including school construction, have usually been financed with general obligation bonds. Indian tribal governments lack a diversified economy as well as the broad, stable tax base such an economy generates.⁸⁶ As a result, they have little ability to issue general obligation bonds, whatever authority the tax code may give them as a matter of law. Thus, in the Tribal Tax Act, tribal governments were given bonding authority they were unable to use and denied bonding authority they would have welcomed.

C. STATUTORY AMBIGUITY AND ITS USES

The requirement that tax exempt bonds be used for "essential governmental functions" introduced further difficulties. "Essential governmental function" is a vague and ambiguous phrase.⁸⁷ What a government considers "essential" differs over time and from government to government. Supreme Court cases involving intergovernmental tax immunities illustrate this point vividly. The Supreme Court in *Helvering v. Powers*⁸⁸ upheld federal income taxation of compensation paid to the trustees of the Boston Elevated Railway Company on the basis that the activity, operating a street railway, was proprietary rather than governmental. Just three years later, the Court, in *Brush v. Commissioner*,⁸⁹ held that the federal government could not tax the salary of the chief engineer of New York's water system, because operation of a water system had developed into an exercise of the city's governmental function. In *New York v. United States*⁹⁰ the Supreme Court conceded that a governmental/proprietary distinction was untenable as a basis for intergovernmental tax immunity. Justice Frankfurter wrote that the distinction was "too entangled in expediency to serve as a dependable legal criterion."⁹¹ Finally, in *Garcia v. San Antonio Metropolitan Transit Authority*⁹² the Supreme Court pointed to the "unworkability" of a distinction between essential and nonessential governmental activities and to the "inability" to give any such distinction "principled content."⁹³

Defining essential governmental functions may pose particular difficulties in

86. See Williams; *supra* note 1, at 385-86. A critical barrier to a stable tribal tax base is the fact that Indian land is held in trust by the federal government. Tribes are therefore unable to mortgage the land or pledge it as collateral for a loan. *Id.* at 344-47.

87. This case study thus also serves as a reminder to administrative law scholars that tax laws are not exclusively "detailed legislation," Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1695 n.127 (1975), or "highly articulated," Louis L. Jaffe, *The Illusion of the Ideal Administration*, 86 HARV. L. REV. 1183, 1188 (1973).

88. 293 U.S. 214, 227 (1934).

89. 300 U.S. 352, 370 (1937).

90. 326 U.S. 572, 583 (1946) (plurality opinion) (Frankfurter, J., announcing the judgment of the Court).

91. *Id.* at 580.

92. 469 U.S. 528 (1985).

93. *Id.* at 543. As the Supreme Court observed:

A State's project is as much a legitimate governmental activity whether it is traditional, or akin to private enterprise, or conducted for profit. . . . A State may deem it as essential to its economy

the case of tribal governments. Because of the lack of a tax base, the absence of private business on reservations, and the need to encourage tribal economic development, tribal governments may well view the distinction between private and public differently from many state and local governments.⁹⁴ Tribal governments, like other governments, need to raise money, but the options open to them have been limited. Given the conditions on the reservations, tribes may see businesses that generate revenues as an essential government function rather than as a rent seeking usurpation of social goods for private use.⁹⁵

Use of an ambiguous phrase such as "essential governmental function" can, of course, serve an important political purpose. In this case, the ambiguous phrase permitted members of Congress to vote for the Tribal Tax Act without resolving the issue of using tribal bonds for economic development. As a result of this ambiguity, both those who supported the idea of tribal bonds for economic development and those, such as Representative Gibbons, who did not, could support the legislation. The parameters of the phrase would await agency interpretation. Each of the opposing groups might have been willing to transfer the decision about whether to permit tribal bonds for economic development to the Treasury Department and the IRS because each thought it could win the "policy lottery."⁹⁶ Although each side ran the risk that the IRS, in interpreting the ambiguous language, would diverge from the group's preference, taking such a risk avoided the need to reach an agreement regarding the legislation's intended range.

The supporters of the tribal governments hoped that the tribal governments, as the group that would benefit from the provision, would work to persuade the IRS to interpret the phrase as permitting economic development. Representative Gibbons expected that the Treasury Department and the IRS would read the

that it own and operate a railroad, a mill, or an irrigation system as it does to own and operate bridges, street lights, or a sewage disposal plant. What might have been viewed in an earlier day as an improvident or even dangerous extension of state activities may today be deemed indispensable.

Reeves, Inc. v. Stake, 447 U.S. 429, 442-43 n.16 (1980) (quoting New York v. United States, 326 U.S. 572, 591 (1946) (Douglas, J., dissenting)). For further discussion of this distinction, see Aprill, *supra* note 30, at 424-29; Michael Wells & Walter Hellerstein, *The Governmental-Proprietary Distinction in Constitutional Law*, 66 VA. L. REV. 1073 (1980).

94. Erin MacLellan, *Indian Tribes Enjoying Fruits of High Finance*, WASH. POST, Oct. 12, 1986, at H3, quotes Tom Tureen, of Tribal Assets Management: "Indian tribes have traditionally been much more involved in developing their economies than a city or local government ever would." Daniel Cohen, *Tribal Enterprise*, ATLANTIC MONTHLY, Oct. 1989, at 32, quotes Alan R. Parker, Staff Director of the Senate Indian Affairs Committee: "For practical purposes, there is no private-sector economy on many reservations." Cf. ZIMMERMAN, *supra* note 22, at 154: "The economic justification for public goods provision suggests that the state and local sector should provide goods and services when external benefits or costs preclude the private sector from providing the socially desirable amount." Because the private sector does not provide economic development, tribal governments see such business as a social need, public good and essential governmental function.

95. The IRS has, after all, interpreted "essential governmental function" for purposes of § 115 as any activity that makes or saves money for the governmental entity. See Rev. Rul. 90-74, 1990-2 C.B. 34; Aprill, *supra* note 30, at 429-50.

96. Peter H. Aranson et al., *A Theory of Legislative Delegation*, 68 CORNELL L. REV. 1, 7 (1982). Under such a model, "legislators will accept risks over the range of possibilities, preferring the gamble implicit in delegated legislative authority—the regulatory lottery—to the equivalent *ex ante* regulatory certainty." *Id.* at 61.

legislative history and the constriction of tribal bond authority during Conference to call for a narrow interpretation of "essential governmental function." Even without statutory clarity, the legislative history, under Representative Gibbons view, would serve as a signal of legislative intent to load the dice for the policy gamble.

No matter how broadly "essential governmental function" is interpreted, giving tribal governments this ability to issue tax-exempt bonds when they lack a tax or other revenue base bestowed little more than symbolic equity with state and local governments. As previously discussed, very few tribal bond offerings took place.⁹⁷ Some analysts have suggested that, like ambiguity, purely symbolic provisions can allow various legislators to protect their position.⁹⁸ Such legislators may intend these provisions to have no real world effect. By enacting the symbolic provisions, the legislators can nonetheless demonstrate power, garner prestige, and promote reelection without the inconvenience and complications of consequences.⁹⁹

Symbolic equity, however, could have some value for the tribal governments. The Internal Revenue Code serves a signaling function.¹⁰⁰ A code provision giving tribal governments the benefits afforded state and local governments acknowledges their sovereignty, even if it has little practical effect. If their economic needs were addressed in other ways, tribal governments might welcome a purely symbolic provision in the tax code. If economic needs are not being addressed, however, symbolism becomes a very expensive luxury; it allows Congress to forestall meaningful action.¹⁰¹ In this case, the symbolic code provision ultimately harmed rather than helped tribal governments.

III. IRS Response to the Tribal Tax Act

A. DEVELOPMENT OF THE REGULATIONS

The supporters of broad tribal bond authority won the first round of the policy lottery. As the parties most concerned about these new provisions of the Internal Revenue Code, those sharing the interest of Indian tribal governments—and, with one possible exception, no one else—offered the Treasury Department advice

97. Moreover, the provision has been amended to make it more, rather than less, difficult for tribal governments to issue tax-exempt bonds, despite the few deals that had been done under the provision. See *infra* notes 166-79 and accompanying text.

98. See Shaviro, *supra* note 80, at 8.

99. *Id.*

100. See WALTER J. BLUM & HARRY KALVEN, *THE UNEASY CASE FOR PROGRESSIVE TAXATION* 84-85 (1963) (explaining the symbolic value of progressivity); Bruce I. Kogan, *The Taxation of Prizes and Awards—Tax Policy Winners and Losers*, 63 WASH. L. REV. 257, 311-12 (1988) ("Congress can and should use the tax laws to make a statement about the kind of society we should become."); Edward J. McCaffery, *The Holy Grail of Tax Simplification*, 1990 WIS. L. REV. 1267, 1309 (discussing the symbolic value of complexity in the tax laws).

101. In fact, the Omnibus Reconciliation Act of 1993 included two tax incentives intended to encourage investment in Indian reservations: accelerated depreciation provisions and a nonrefundable income tax credit given to employers for certain wage and health insurance costs. See Omnibus Reconciliation Act of 1993, Pub. L. No. 103-66, §§ 13321-22, 107 Stat. 312, 558-63 (to be codified at I.R.C. §§ 168(j), 38(b)(10), 45A, 196(c), 280C(a) and 39(d)(5)).

on the content of the regulations.¹⁰² In particular, the law firm of Fried, Frank, Harris, Shriver & Kampelman made lengthy comments.¹⁰³ In June 1983, the firm submitted a memorandum on behalf of a number of Indian tribes,¹⁰⁴ urging the Treasury Department to interpret the "essential governmental functions" requirement of the statute broadly, because section 7871 "was intended to provide relief to Indians and should be construed in a favorable fashion."¹⁰⁵

The Fried, Frank memorandum suggested that "essential governmental function" be defined for purposes of section 7871 to include not only activities that would be tax-exempt if conducted by a state or local government, but also any tribal activity federally funded or eligible for federal funding.¹⁰⁶ In particular, the submission asked the Internal Revenue Service to treat as an "essential governmental function" any activity funded by the Bureau of Indian Affairs under the Snyder Act¹⁰⁷ and the Indian Self-Determination Act.¹⁰⁸ Both of these provisions support a broad range of activities. The Snyder Act authorizes expenditures for, among other activities, "[g]eneral support" as well as "industrial assistance and advancement and general administration of Indian property."¹⁰⁹ The Indian Self-Determination Act authorizes the Secretary of the Interior to make grants to strengthen or improve tribal government, "including, but not limited to, . . . the improvement of tribally funded programs or activities; or the development, construction, improvement, maintenance, preservation, or operation of tribal facilities or resources."¹¹⁰

The Fried, Frank submission does not consider the legislative history limiting tribal government authority to issue tax-exempt bonds or cite to the examples of

102. Others who submitted comments on the regulations were as follows: Elizabeth Bernstein, Navajo Nation Department of Justice, 24 TAX NOTES 342 (1984); A. Reed Marbut, Montana State Senator, 22 TAX NOTES 401 (1984); Raymond R. Smith, Navajo Arts and Crafts Enterprise, 24 TAX NOTES 342 (1984); Robert Robertson and Ross Swimmer, Co-Chairs of the Presidential Commission on Indian Reservation Economies, 22 TAX NOTES 581 (1984); and Darrell Wadena, Chair of the White Earth (Chippewas) Reservation Business Committee, 24 TAX NOTES 234 (1984). Mr. Marbut asked for prompt publication of regulations. All the others asked for a broad interpretation of "essential governmental function."

103. The firm had for many years represented a number of tribal governments and alliances. One of its partners, Felix Cohen, author of a handbook on Indian Law and principal drafter of the Indian Reorganization Act of 1934, began handling matters for tribal governments in the 1950s. Kathleen Sylvester, *Which Firms Represent the Tribes?*, NAT'L L.J., May 23, 1983, at 34. Arthur Lazarus, who submitted the memorandum on the section 7871 regulations, served as general counsel to the Association on American Indian Affairs in the 1960s and 1970s. EDWARD LAZARUS, *BLACK HILLS, WHITE JUSTICE: THE SIOUX NATION VERSUS THE UNITED STATES, 1775 TO THE PRESENT* 313-14 (1991).

104. The tribes included the Cheyenne River Sioux Tribe of South Dakota, the Laguna Pueblo of New Mexico, the Nez Perce Tribe of Idaho and the Seneca Nation of Indians in New York. Letter & Memorandum from Fried, Frank, Harris, Shriver & Kampelman to Hugo Santora, Legislative Analysis Officer, Internal Revenue Service 1 (June 28, 1983) (on file with author) [hereinafter Fried, Frank Memorandum].

105. *Id.* at 11.

106. *Id.* at 11-12.

107. 25 U.S.C. § 13 (1988).

108. Fried, Frank Memorandum, *supra* note 104, at 2-4. See 25 U.S.C. § 450 (1988 & Supp. III 1991).

109. 25 U.S.C. § 13 (1988).

110. 25 U.S.C. § 450h(a)(1) (1988).

essential governmental functions given in the Conference Report.¹¹¹ Instead, the submission states that the relevant legislative history makes no attempt to define the phrase.¹¹² This claim, while literally true, is inconsistent with the tenor of the Conference Report and with the narrowing of the tribal bond provision in Conference.

The Treasury regulations promulgated under section 7871 nonetheless adopted in detail each of the positions urged in the Fried, Frank memorandum. The section 7871 regulations follow the statute in requiring that an Indian tribal government use substantially all the proceeds of the tax-exempt financing in the exercise of any essential governmental function.¹¹³ The regulations, however, define the essential governmental functions of an Indian tribal government to include any function of a type “(1) [e]ligible for funding under 25 U.S.C. 13 and the regulations thereunder; (2) [e]ligible for grants or contracts under 25 U.S.C. 450(f), (g), and (h) and the regulations thereunder; or (3) [a]n essential governmental function under section 115 and the regulations thereunder when conducted by a State or political subdivision thereof.”¹¹⁴

Such regulations broadened the meaning of “essential governmental functions” far beyond the schools, streets, and sewers envisioned by the Conference Committee. These regulations authorized the tribal governments to issue bonds for industrial and commercial activities owned and operated by the tribe itself. Regulations promulgated under the Snyder Act authorize grants

for the establishment or expansion of locally determined profit making economic enterprises which generate income and employment opportunities for participating tribes [and] . . . [s]erve as an inducement when combined with a tribe’s financial and other resources to attract private sector investment or loans from private lending institutions for the development of the tribe’s resources.¹¹⁵

Regulations under the Self-Determination Act list the Bureau of Indian Affairs’s revolving loan fund among the Act’s business-related functions, and the regula-

111. Fried, Frank Memorandum, *supra* note 104, at 3-14. The memorandum did describe the judicial interpretation of essential governmental functions under § 115, which excludes from federal taxation “‘income derived from . . . the exercise of any essential governmental function accruing to a State.’” *Id.* at 4 (quoting I.R.C. § 115(a)(1) (1993)). The memorandum concluded that a determination of essential governmental function under § 115 requires a consideration of the burden of taxation on the state, the needs of the community, and the competition with private enterprise. *Id.* at 11-12.

112. *Id.* at 1-2.

113. Regulation § 305.7701-1 defines Indian tribal government. It states that “[a] governing body of a tribe, band, pueblo, community, village, or group of native American Indians, or Alaska Natives, qualifies as an Indian tribal government upon determination by the Internal Revenue Service that the governing body exercises governmental functions.” Treas. Reg. § 305.7701-1 (1984). Under I.R.C. § 7701(40), governing bodies apply to the IRS for a ruling that they qualify as an Indian tribal government and the IRS publishes a list of such bodies. *See* Rev. Proc. 84-37, 1984-1 C.B. 513. Indian tribal governments and subdivisions number approximately 450. I.R.C. § 7701(40) (1988). *See* Rev. Proc. 84-36, 1984-1 C.B. 510, 511-13; Rev. Proc. 83-87, 1983-2 C.B. 606, 606-13.

114. Treas. Reg. § 305.7871-1(d) (1984); T.D. 7952, 1984-1 C.B. 276 (promulgated as temporary regulations, with Notice of Proposed Rulemaking by cross-reference to temporary regulations on 5-7-84); 49 Fed. Reg. 19,302. Although the regulations under § 7871 reference § 115 and the regulations thereunder, there are not and have never been any regulations under § 115.

115. 25 C.F.R. § 278.11 (1993).

tions for the revolving loan fund authorize loans "to finance economic enterprises operated for profit, the operation of which will contribute to the improvement of the economy of a reservation."¹¹⁶

Thus, under the section 7871 regulations, wisely or unwisely, the range of activities that can be financed with tax-exempt bonds, if conducted directly by the tribal government, extended beyond the traditional governmental projects intended by the legislative coalition in enacting the statute. The regulations went beyond even the more generous provisions of the Senate bill, which would have allowed tribes to issue tax-exempt PABs, but nonetheless limited the ability of the tribal government itself to issue tax-exempt bonds for the conduct of commercial or industrial activities.¹¹⁷

B. ADMINISTRATIVE DISCRETION, LEGISLATIVE HISTORY, AND REGULATORY BIAS

In interpreting the ambiguous statutory language, the IRS exercised its discretion to benefit the interested party. Moreover, the agency gave no indication that it considered the legislative history when it drafted the regulations. Some prominent scholars would support this approach. They have urged that, at least when it comes to judicial interpretation of statutory language, legislative history should not have weight and that the language of the statute should control statutory interpretation.¹¹⁸ They base these arguments on a variety of considerations: that a government body cannot have "intent"; that legislators do not read or vote based on legislative history; that ours should be a government of law.¹¹⁹

In contrast, others have asserted that legislative history, in the form of committee reports, carries particular weight, at least for tax legislation.¹²⁰ Still others believe that, in the case of ambiguous statutes, whether or not related to tax, legislative history should receive careful attention.¹²¹ As Daniel Farber and Philip Frickey

116. 25 C.F.R. § 101.2(b)(1) (1993).

117. See *supra* text accompanying notes 61-62.

118. Justice Scalia is well known for taking the view that legislative history should not be afforded weight. See, e.g., *Conroy v. Aniskoff*, 113 S. Ct. 1562, 1567 (1993) (Scalia, J., concurring in judgment but rejecting majority's reliance on legislative history); *Blanchard v. Bergeron*, 489 U.S. 87, 98-99 (1989). See generally Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533 (1983) (arguing for limiting judicial construction to statutes that explicitly address a matter or commit the matter to common law); Richard A. Posner, *Statutory Interpretation—in the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800 (1983) (discussing canons of statutory construction and basic need for legislative education in law school).

119. See DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE* 88-92 (1991).

120. "[M]embers (or their staffs) are at least as likely to read the committee reports as they are to consult the statutory language. . . . In fact, legislative history is before the House and Senate when they vote on a tax bill and is, if anything, more closely considered than the actual statute." Livingston, *supra* note 58, at 836, 874. See also Ferguson et al., *supra* note 58, at 807 ("[M]embers rely entirely on the committee reports that describe what the bill is intended to do, on 'official' colloquies that supplement the committee reports, and on oral descriptions and pamphlets presented by the tax staffs participating in the legislative process."). For a critical analysis of the extent to which Ferguson, Hickman, and Lubick would give some legislative history parity with the statute itself, see James B. Lewis, *Viewpoint: The Nature and Role of Tax Legislative History*, 68 TAXES 442 (1990) and Bradford L. Ferguson et al., *Response: Adapting to the Evolving Legislative Process*, 68 TAXES 448 (1990).

121. See William N. Eskridge, *Dynamic Statutory Interpretation*, 135 U. PA. L. REV. 1479 (1987); Livingston, *supra* note 58; Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 HARV. L. REV. 405 (1989). The issue at hand is the extent to which administrative agencies should be guided by legislative history. The concerns, of course, are not identical.

have said of judicial interpretation, “American public law has quite properly recognized that statutory meaning is greatly colored by statutory context. Legislative history is part of that context, and some aspects of it—frequently, for example, a committee report—will often represent the most intelligent exposition available of what the statute is all about.”¹²² If such is true for judicial interpretation, we would expect it to be even more so for administrative agencies. As Peter Strauss has written, “Legislative history speaks to the agency much more loudly than it does to the court, which does not have to undergo continuing relationships of oversight and budgetary dependency.”¹²³

The IRS, however, did not carefully heed the legislative history of the tribal bond provision. As Strauss goes on to observe,

Courts have long recognized the “contemporaneous construction[s]” of statutes by those appointed to administer them as powerful indicators of statutory meaning. They have done so, in substantial part, because of the agency’s fuller and more accurate political sense of the situation. . . . The agency, if a participant in the drafting, may well have tools to distinguish false from valid signals of full congressional politics that a court would lack.¹²⁴

Thus, the Treasury and the IRS may have considered and rejected Representative Gibbons’s view of the legislation and the legislative history as not representing the general congressional will, but only a minority view. Subsequent events, however, demonstrate that Representative Gibbons could in fact command a majority for the purpose of denying tribal governments the authority to issue bonds for tribal enterprises designed to raise revenue.¹²⁵ In retrospect, it is easy to say that the Treasury erred in ignoring the tenor of the legislative history. When the regulations were promulgated, however, the subtle message of the legislative history may have been far more obscure. The ambiguity of the term “essential governmental function” precluded the Treasury from taking the kind of literal interpretation in the regulations that the IRS had in its tribal revenue rulings. The phrase “essential governmental function” calls for a policy oriented interpretation, and the Fried, Frank memorandum supplied precisely such an interpretation. Its position was a plausible construction of the statutory language. Although it was inconsistent with the thrust of the legislative history, the Treasury adopted the offered interpretation.

122. FARBER & FRICKEY, *supra* note 119, at 100. *See also id.* at 92 (discussing the particular need for legislative history in interpreting ambiguous language). These discussions, like others regarding statutory interpretation, focus on the role of federal courts.

123. Peter L. Strauss, *Legislative Theory and the Rule of Law: Some Comments on Rubin*, 89 COLUM. L. REV. 427, 438 (1989). *See also* Cynthia R. Farina, *Statutory Interpretation and the Balance of Power in the Administrative State*, 89 COLUM. L. REV. 452 (1989) (discussing dangers of deference to agency statutory interpretation); Edward L. Rubin, *Law and Legislation in the Administrative State*, 89 COLUM. L. REV. 369 (1989) (proposing that legislative process should be revamped to better achieve social purposes).

124. Strauss, *supra* note 123, at 438. *See* Peter L. Strauss, *When the Judge Is Not the Primary Official with Responsibility to Read: Agency Interpretation and the Problem of Legislative History*, 66 CHI.-KENT L. REV. 321 (1990) (criticizing the interpretive model that assumes judges are primary interpreters of legislation).

125. *See infra* part IV.B.

By foregoing clarity in both the statutory language and the legislative history, Congress increased the discretion of the Treasury Department and the Internal Revenue Service. Declining to cabin the meaning of "essential governmental function" itself, the congressional coalition left resolution of the issue to the judgment of the administrative agencies. Perhaps responding to the need of tribal governments for revenue and economic development, the administrative agencies chose to exercise this discretion in favor of the tribal governments. The administrative agencies, guided by representatives of the tribal governments, may well have used their own sense of the legislation's purpose to interpret the ambiguous language. That is, the Treasury Department and the IRS may have exercised their independent judgment to conclude that such an interpretation best served the overall purpose of the legislation, the federal government's fiduciary responsibility toward the tribal governments, and the federal policy of encouraging economic self-sufficiency for the tribal governments.¹²⁶ Indeed, this case study may be seen as demonstrating an advantage of administrative discretion: The limited political power of the tribal governments, compared to that of state and local governments, prevented them from fully achieving their purpose in Congress. Because the administrative agencies were insulated from direct partisan politics, they were able to make a disinterested judgment that tribal economic development should be encouraged.¹²⁷

Yet, the lessons of administrative law scholarship should lead us to expect that the exercise of an agency's discretion would tend to favor the regulated party. That is, the leniency of the regulations may not simply reflect disinterested judgment, but instead emerge as a function of the regulatory process.¹²⁸ As Richard Stewart has put it: "[T]he comparative over-representation of regulated or client interests in the process of agency decision results in a persistent policy bias in favor of these interests."¹²⁹ The Treasury Department and the IRS are frequently insulated from this policy bias. Many tax statutes are so specific as to leave little room for agency discretion. Other tax provisions affect large numbers and varieties of taxpayers—individuals and corporations, retailers and manufacturers, large and small, wealthy and poor—with numerous and conflicting points of view and many trade associations or lobbyists. These various interest groups express their points of view to the

126. See Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 YALE L. J. 31, 48-59 (1991) (explaining the need for normative baseline to identify disproportionate interest group influence). Cf. Jonathan R. Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 250-56 (1986) (arguing that judges do and should construe ambiguous statutes designed to benefit narrow interest groups as statutes that further public interest).

127. See Jerry L. Mashaw, *Prodelegation: Why Administrators Should Make Political Decisions*, 1 J.L. ECON. & ORGANIZATION 81, 92 (1985) (policy lottery may produce agency action that enhances welfare).

128. The reference in the § 7871 regulations to nonexistent regulations under § 115 is strong evidence of the influence of the Fried, Frank memorandum on the regulatory process. It suggests an uncritical adoption of the position urged by the tribal governments. Although there were no regulations under § 115 at the time the § 7871 regulations were adopted, the IRS had issued two published rulings and many private rulings involving § 115. See Gen. Couns. Mem. 14,407 (Jan. 28, 1935); Rev. Rul. 77-261, 1977-2 C.B. 45; Priv. Ltr. Rul. 82-37-063 (June 16, 1982); Priv. Ltr. Rul. 82-24-124 (Mar. 22, 1982). Neither the Fried, Frank memorandum nor the § 7871 regulations cite to the rulings issued under § 115, even though they lend support to the tribal governments' position.

129. Stewart, *supra* note 87, at 1713.

IRS and Treasury as well as to Congress. The diverse interests of the affected taxpayers will produce regulations with a kind of balance.¹³⁰ Regulations implementing the alternative minimum tax, for example, will affect individuals and corporations, manufacturers and service providers.¹³¹ The passive loss provisions have their largest impact on real estate, but even there they affect both developers and investors.¹³² The provisions regarding religious, charitable, literary and educational organizations¹³³ affect a wide variety of groups, from universities to museums to homeless shelters, all of which have varying points of view.

Section 7871, in contrast, affects a clearly defined and relatively small category of persons: tribal governments and their political subdivisions.¹³⁴ Although not a wealthy or powerful group, tribal governments are easy to identify and relatively well organized. The ability to issue tax-exempt bonds is important to many members of the group. No member of the group has an interest in discouraging economic development, and no other clearly defined group has an adverse interest. Because only those affected by the regulation have an incentive to incur the costs of involvement in the regulatory process, this interest group's point of view dominates. Information obtained by the IRS and Treasury in administering the statute, including drafting the regulations, is largely limited to this group.¹³⁵ In this case, it is very likely that the Fried, Frank memorandum made the IRS and Treasury aware of the Bureau of Indian Affairs (BIA) regulations later incorporated into the tax regulations.¹³⁶ The Treasury must rely on a self-interested group for information related to the statute, and the regulations reflect this interest. In the case of the tribal bond provisions, there is no evidence that any group or individual came to Treasury and IRS to express the view, held by at least some in Congress, that the provisions should be interpreted narrowly.¹³⁷ In these circumstances, we

130. See Livingston, *supra* note 58, at 843 ("[T]ax legislation involves not two or three, but literally hundreds of different interest groups, each represented by one or more different members of Congress."); Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165, 1166 (1993) (arguing that tax institutions less subject to capture because subject to more numerous and diverse clientele).

131. See I.R.C. §§ 55-59 (1988 & Supp. IV 1992) and regulations thereunder.

132. See I.R.C. § 469 (1988 & Supp. IV 1992) and regulations thereunder.

133. See I.R.C. § 501(c)(3) (1988).

134. See *supra* note 113.

135. Some commentators have called this influence a form of capture: "[I]f the generalists who write and administer the tax laws are not knowledgeable about particular substantive areas of government, their lack of expertise engenders a form of capture stemming from their consequent dependence on the information provided by interest groups." Zelinsky, *supra* note 130, at 1184. The classic definition of capture would involve "a small number of producers who are able to overcome free riding costs and organize to wield *complete* (wealth-maximizing) influence over regulators." Tollison, *supra* note 80, at 591.

136. The IRS and BIA, of course, may also have consulted directly. Cross-reference to regulations promulgated by the administrative agency closely aligned with tribal governments increases the "enhanced influence of the affected clientele groups." See Zelinsky, *supra* note 130, at 1191. The BIA, however, may act to increase its budget and influence rather than favor the clientele group. See Fred S. McChesney, *Government as Definer of Property Rights: Indian Lands, Ethnic Externalities, and Bureaucratic Budgets*, 19 J. LEGAL STUD. 297, 298 (1990) (BIA changing position vis a vis allotment policy best explained as an effort to increase the agency's budget).

137. See *infra* Part I.V.C. for discussion of congressional monitoring of the administrative process.

would expect that the regulations would favor the regulated party, and such was the case.¹³⁸

Of course, Congress itself is susceptible to the influence of special interest groups. The success of special interest groups in getting tax legislation for their own benefit is well known.¹³⁹ Whether, in general, legislators or administrative agencies are more susceptible to the influence of interest groups is a matter of scholarly debate.¹⁴⁰ In the case of tribal bonds, however, the views of one legislator who was a member of the Ways and Means Committee provided a counter to the interests of the tribal governments at the legislative level. No such counter operated at the administrative level, and the regulations reflected the view of the affected group. That is, this example demonstrates that there are occasions when the rulemaking agency will be more influenced by the regulated interests than will the congressional coalition that supported the legislation. In such cases, the dynamics of the regulatory process produce a substantial possibility that administrative action will favor the regulatory party. Such favoritism may well be consistent with the agency's vision of the public interest. The agency's vision, however, may nonetheless diverge from congressional intent embodied in the original legislative bargain.

IV. Consequences of the Regulations

A. TRIBAL BOND OFFERINGS AFTER THE REGULATIONS

Despite the generous provisions of the regulations, few Indian tribal governments in fact were able to issue tax-exempt bonds. Prior to January 1988, when Congress revised the Tribal Tax Act, reported tribal issues numbered only seven.¹⁴¹ The offerings were generally private, small offerings; they totalled just under \$300 million.¹⁴² Of the seven offerings, only one involved an on-reservation project for a traditional public purpose. In that case, an offering of \$750,000 for

138. Thus, this case study also serves as an important reminder that the IRS, despite its mandate to protect the federal fisc, is not always anti-taxpayer. For recent examples of regulations that some consider too favorable to the regulated group, see Lee A. Sheppard, *News Analysis: The Goldberg Variations, Or: Giving Away the Store*, 58 TAX NOTES 530, 532-33 (1993). Some years ago Professor Asimow prepared a "laundry list" of a dozen lenient IRS rules. See Michael Asimow, *Standing to Challenge Lenient Tax Rules: A Statutory Solution*, 57 TAXES 483, 484-85 (1979).

139. See Shaviro, *supra* note 80, at 55-56 and authorities cited in his footnote 254; Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913, 955-59 (1987) (detailing influence of insurance, oil and gas, timber and steel industries on Tax Reform Act of 1986).

140. Compare William H. Page, *Interest Groups, Antitrust, and State Regulation*, 1987 DUKE L.J. 618 (632-37) (agencies more susceptible) with Mashaw, *supra* note 127, at 95-96 (agencies less susceptible) and John S. Wiley, Jr., *A Capture Theory of Antitrust Federalism: Reply to Professors Page and Spitzer*, 61 S. CAL. L. REV. 1327, 1331-33 (1988) (agencies less). See also *supra* note 96, at 51-52 (dispute as to whether agencies act to further own interest or interest of their overseeing legislators); Linda R. Hirshman, *Postmodern Jurisprudence and the Problem of Administrative Discretion*, 82 NW. U. L. REV. 646, 663-64 (1988) (response to Mashaw).

141. John J. Doran, *Indian Tribes Find Development Is Hindered by New Budget Law*, BOND BUYER, Dec. 28, 1987, at 1.

142. See *id.*

the construction of a health clinic by the Fond du Lac Band of Lake Superior Chippewa Indians, the purpose complicated the offering. Because it did not levy taxes, the tribal government found it difficult to secure the debt. The issue had to be backed by revenues from the health care building and a bingo hall on the reservation.¹⁴³

All the other projects funded by tribal bonds were off-reservation leveraged buy-outs.¹⁴⁴ The enterprises purchased were intended to promote tribal economic development, albeit indirectly, by generating profits that could be used by the tribe to improve tribal conditions. The Salt River Pima-Maricopa Indians in Arizona, for example, issued \$61 million of bonds to purchase a cement factory.¹⁴⁵ The manager of the Salt River Tribes stated that the cement plant was purchased primarily as "an investment so we can earn income" to finance other tribal services.¹⁴⁶

Like the Salt River Pima-Maricopa, the Passamaquoddy Tribe of Maine purchased a cement plant with the proceeds of its bond offering. The Passamaquoddy plant generated no jobs for tribal members, but it did generate large gains. The tribe sold the cement plant in 1988 for over \$80 million, an amount which represented more than three times the price the tribe paid for the plant five years before, and a \$60 million profit.¹⁴⁷ The success of this investment has made it the focus of a Harvard Business School case study.¹⁴⁸ The tribe used a portion of the business profits to establish language programs and tribal museum projects.¹⁴⁹ In addition, when it sold the plant, the tribe kept ownership of an innovative scrubber antipollution strategy, which the tribe is developing and plans to market through an incorporated subsidiary.¹⁵⁰

The largest of the Indian bond offerings, \$125 million in bonds sold by the Sac and Fox Tribe of Oklahoma to purchase unspecified oil and gas wells, received as much negative publicity as the Passamaquoddy's offering garnered positive press. The Sac and Fox Tribe had hoped that profits from the oil and gas wells

143. Joe Mysak, *Tomorrow's \$750,000 Chippewa Issue to Be First Municipal Sale by Indians*, BOND BUYER, June 18, 1985, at 1.

144. The projects were a \$61 million off-reservation leveraged buy-out of a cement factory by the Salt River Pima-Maricopa Indians in Arizona; a \$32 million off-reservation purchase of the Carolina Mirror Factory by the Eastern band of Cherokees; a \$25 million off-reservation purchase of an electronics firm by the Wisconsin Lac du Flambeau Band of Lake Superior; a \$25 million off-reservation purchase of the Dragon Cement Co. by the Passamaquoddy Tribe of Maine; a \$30.2 million purchase by the Jicarilla Apache of New Mexico of a 55,000 acre ranch adjoining its reservation; and a \$125 million offering by Sac & Fox Tribe of Oklahoma to purchase unspecified oil and gas wells. Doran, *supra* note 141, at 1. A leveraged buy-out involves the purchase of a company by investors, "usually financed in large part by use of the company's own funds or assets." WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 166 (4th ed. 1990). The purchasers "generally borrow a substantial portion of the purchase price, using the assets of the target as the security for the debt." *Id.*

145. Doran, *supra* note 141, at 1.

146. Joan Pryde, *Two Bond Issues Sold by Tribes May Face Review by Congress*, BOND BUYER, June 9, 1987, at 1.

147. *Id.*

148. Kate Ballen, *Maine Indians as B-School Study*, FORTUNE, Apr. 22, 1991, at 16.

149. Robert H. White, *Indians' New Harvest*, N.Y. TIMES, Nov. 22, 1990, at A27.

150. Emily Barker, *Mapping New Territory for Native Americans*, AM. LAW., Nov. 1991, at 82.

would generate income to use for medical facilities, emergency services, roads, sewers, and schools.¹⁵¹ The Sac and Fox offering, however, was underwritten by Matthews and Wright, many of whose tax-exempt bond deals were investigated by the SEC and the IRS.¹⁵² The Sac and Fox offering received considerable press as part of the Matthews and Wright scandal.¹⁵³

In 1987, the tribal offerings received additional press. The Tax Reform Act of 1986 had imposed onerous new restrictions on tax-exempt bonds, including volume restrictions on PABs.¹⁵⁴ Tribal governments, however, were not subject to these restrictions, because they were not permitted to issue any PABs. On June 15, 1987, *Forbes* magazine published an article describing Wall Street Firms as lining up to help American Indian tribes because of their exemption from these volume restrictions.¹⁵⁵ The article did not explain the distinction between tribal bonds and PABs. Given the kind of projects financed with tribal bonds, *Forbes*, as well as the Wall Street firms, apparently considered the tribal bonds to be a form of PABs.

The article also stated, "Promoters have been interpreting [the essential governmental purpose] restriction so broadly you could lead a cavalry charge through it. To the promoter, 'essential services' now seems to mean any project—whether it is situated on or off the reservation—that might arguably bring revenues to a tribe."¹⁵⁶ The article failed to note that, like tribal governments, state and local governments could themselves engage in income-producing enterprises financed with tax-exempt bonds.¹⁵⁷ Neither did it observe that the definition of "essential services" criticized in the *Forbes* article is precisely that used by the Internal Revenue Service for state and local governments.

Most significantly, the *Forbes* article did not cite or discuss the regulations promulgated under the Tribal Tax Act. Bond counsel had given favorable opinion on the tax-exempt status of the tribal bond in reliance not on the promoters' interpretation, but on the Treasury regulations defining essential governmental

151. Daniel J. Shea & Robert Taylor, *Issuers in Matthews & Wright Deals See Dream Projects Threatened*, BOND BUYER, July 6, 1987, at 1.

152. *Id.*; John J. Doran, *Navajo Nation Plans \$100 Million Issue*, BOND BUYER, Sept. 30, 1988, at 1; Vicky Stamas, *In Wake of Sham Deal, Sac and Fox Indians Use Arbitrage to Fund Defense Contract Work*, BOND BUYER, Feb. 6, 1990, at 1; Vicky Stamas & Lynn Stevens, *IRS May Act Against 26 Deals Closed by Matthews & Wright*, BOND BUYER, Dec. 21, 1989, at 1. The Matthews and Wright scandal was one of the causes for the Securities and Exchange Commission increasing disclosure requirements for underwriters of state and local bonds. See ZIMMERMAN, *supra* note 22, at 49-50.

153. See *supra* note 152.

154. See I.R.C. §§ 141-47 (1988). Each state was limited to a volume cap for tax-exempt PABs equal to the greater of \$50 per capita or \$150 million. See ZIMMERMAN, *supra* note 22, at 209-11, 287-323; Michael Livingston, *Reform or Revolution? Tax-Exempt Bonds, the Legislative Process, and the Meaning of Tax Reform*, 22 U.C. DAVIS L. REV. 1165, 1206-07 (1989).

155. Matthew Schiffrin, *Smoke Signals*, FORBES, June 15, 1987, at 42.

156. *Id.*

157. Zimmerman, *supra* note 22, at 271-75, describes governmental enterprises encouraged by the bond provisions as "municipal socialism." Such municipal socialism has at times met with congressional opposition. At the same time it amended the tribal bond provisions, Congress passed a provision limiting the further use of tax-exempt bonds for governments to acquire existing electric generating and transmission systems or gas distribution systems. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10631(a), 101 Stat. 1330-455 (codified as amended at I.R.C. § 141(d) (1988)).

purposes by cross-reference to BIA regulations.¹⁵⁸ In the case of the purchase of the cement plant by Arizona's Salt River Pima-Maricopa Indians, for example, bond counsel sought and received assurances from the BIA that the cement-plant purchase would have qualified for a grant or loan guarantee for economic development, if the tribe had requested one.¹⁵⁹

The tribal governments selling these tax-exempt bonds all wished to raise revenue for traditional projects—schools, medical facilities, sewers, and roads. Governments commonly fund these types of projects directly with tax-exempt bonds. Tribal governments, however, were unable to do so because they lacked the revenue base to support such bonds, and they turned to manufacturing facilities, the kind of projects that governments often fund with tax-exempt PABs. Tribes were unable, however, to offer PABs, because the Tribal Tax Act prohibited tribal PABs.¹⁶⁰ Instead, the tribes, using the definition of “essential governmental function” of the section 7871 regulations, turned to complicated structures in which the tribe itself owned and operated the projects.¹⁶¹ Sometimes the tribes were able to find underwriters to sell such projects, sometimes not. Sometimes the tribes were able to operate the business successfully, sometimes not.

The limitations of the Tribal Tax Act steered the tribal governments toward risky leveraged buy-outs. The Tribal Tax Act prevented the tribal governments from developing private-public partnerships for economic development on the reservation and instead directed them toward undertaking off-reservation business enterprises designed to raise revenue.

B. CONGRESSIONAL RESPONSE TO THE OFFERINGS

The critical press coverage sounded an alarm for Congress.¹⁶² In particular, the Indian tribal governmental offerings came to the attention of Representative Gibbons of Florida, who had had the key role in introducing limitations on tax-

158. Joan Pryde, *Legislator Urges Repeal of Portion of Rules on Bond Sales by Indians*, BOND BUYER, Sept. 14, 1987, at 1.

159. *Id.* The Sac and Fox tribe's bond counsel “requested and received a private-letter ruling from the IRS affirming the bonds' tax-exempt status.” *Id.*

160. Nor would these particular projects necessarily have qualified under the then-applicable rules, because they were too large for the small-issue exception. *See supra* text accompanying notes 50–54 (description of PAB rules). If tribal governments had been permitted to issue PABs, however, tribal governments would likely have sought projects that so qualified.

161. For example, the Tulalip Tribe of Washington State considered a plan to build a regional garbage-to-energy plant on its reservation through a sale of \$381 million of tax-exempt bonds. In order to comply with the Tribal Tax Act and avoid the bonds being classified as taxable PABs, the tribe would have had to own the plant and the company's contract to run the plant would have had to last only five years. In a typical structure unconstrained by the Tribal Tax Act, the company that built and operated the plant would have owned it. *See* John J. Doran, *Washington State Indian Tribe Proposes \$381 Million Bond Sale for Waste Plant*, BOND BUYER, Feb. 4, 1987, at 1. This offering was never completed. To prevent some of these problems, Sen. John McCain, III (R-Ariz.) and Rep. Morris Udall, (D-Ariz.) introduced a bill that would have permitted the tribal governments to sell tax-exempt PABs. John J. Doran, *Congressional Committees Consider Bill to Let Indian Tribes Sell Tax Free IDBs*, BOND BUYER, May 20, 1987, at 6. As discussed *infra*, however, the restrictions were tightened, not loosened. *See infra* notes 166–79 and accompanying text.

162. *See* Pryde, *supra* note 146. The press often has an important role to play in tax legislation. *See* Shaviro, *supra* note 80, at 30, 96–98.

exempt financing in the 1982 Tribal Tax Act. Unlike the author of the *Forbes* article, Representative Gibbons quickly realized the significance of the regulations. For him, the administrative action clearly diverged from the original legislative bargain. On September 10, 1987, he wrote to Treasury Secretary James Baker urging the department to investigate recent bond issues sold by Indian tribes.¹⁶³ He described tribal governments as using tax-exempt bonds for purposes never intended by Congress and urged that the Treasury Department immediately revoke the portion of the regulations defining essential governmental functions.¹⁶⁴ Representative Gibbons did not see these governmental actions designed to generate revenues as an essential governmental function: "Cement plants and mirror factories are a far cry from school, streets, and sewers."¹⁶⁵ The *Forbes* article may also have prompted concern that bond offerings under the regulations, heretofore of negligible fiscal impact, would soon produce a large revenue loss.

As part of the Omnibus Budget Reconciliation Act of 1987,¹⁶⁶ Representative Gibbons sponsored a measure to tighten the tribal bond measures by limiting essential governmental functions to those customarily financed with exempt bonds by state and local governments.¹⁶⁷ The House included the provision, and the legislative history does not mince words. In unusually harsh language, it condemned the regulations as invalid:

[I]ssuance of bonds to finance commercial or industrial facilities (e.g., private rental housing, cement factories, or mirror factories) which bonds technically may not be private activity bonds is not included within the scope of the essential governmental function exception. . . . Additionally, the committee wishes to stress that only those activities that are *customarily* financed with governmental bonds (e.g., schools, roads, government buildings, etc.) are intended to be within the scope of this exception, notwithstanding that isolated instances of a State or local government issuing bonds for another activity may occur. Further, the fact that the Bureau of Indian Affairs may provide Federal assistance for Indian tribal governments to engage in commercial and industrial ventures as tribal government activities is not intended to be determinative for purposes of the Internal Revenue Code. (Any existing Treasury Department regulations that may infer a contrary result are to be treated as invalid.)¹⁶⁸

The Senate's version of the Omnibus Budget Reconciliation Act, S. 1920, did not contain any language regarding tribal bond authority. After passage of the Senate version and before a House-Senate Conference Committee met to resolve

163. Pryde, *supra* note 146, at 1.

164. *Id.*

165. *Id.* Gibbons's letter also discusses his concern that the Indian offerings violate the arbitrage rules, which limit the ability to borrow funds at a lower tax-exempt rate and invest them at a higher rate, usually in other securities. *Id.* See ZIMMERMAN, *supra* note 22, at 158-62. The Tax Reform Act of 1986 tightened the restrictions on such arbitrage profits. See Pub. L. No. 99-514, § 1301(b), 100 Stat. 2085, 2602-03 (codified at I.R.C. § 148 (1993)). The Sac and Fox offering in particular raised arbitrage concerns. See John J. Doran, *Tribes Are Increasingly Eager to Issue Tax-Exempt Bonds Despite Obstacles*, BOND BUYER, June 24, 1987, at 5.

166. Pub. L. No. 100-203, 101 Stat. 1330 (1987).

167. John J. Doran, *Indian Affairs Agency Is Writing Regulations to Increase Its Role in Tribal Bond Matters*, BOND BUYER, Nov. 4, 1987, at 1.

168. H.R. REP. NO. 391, 100th Cong., 1st Sess., pt. 2, at 1139 (1987).

the differences in the bills,¹⁶⁹ 22 senators sent a letter to Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, opposing the Gibbons's amendment to the tribal bond provisions.¹⁷⁰ These Senators urged instead that any amendment to the Tribal Tax Act be more precisely targeted to potential abuses.¹⁷¹ They suggested defining essential governmental function to exclude economic development that would produce only passive income from investment in real estate or natural resources not located on a reservation or in Indian country, but to permit activities that decrease tribal unemployment, alleviate poverty, preserve natural or cultural resources of the tribe or contribute to tribal economic activity.¹⁷²

The Conference Committee, however, adopted the amendment urged by Representative Gibbons. As enacted, the 1987 amendments to the Tribal Tax Act limited the meaning of "essential governmental activity." The amendment excluded from the definition "any function which is not customarily performed by State and local governments with general taxing powers."¹⁷³ In response to the concerns raised by the Senators, the 1987 amendments did permit tribal governments to issue one special category of bonds for industrial purposes.¹⁷⁴ The proceeds of these special bonds had to be used for manufacturing facilities that were owned and operated by the tribal government on tribal lands, and that employed tribal members.¹⁷⁵ According to the Conference Report, the conferees adopted this limited exception "in recognition of the unique responsibilities of Indian tribal governments in managing historical tribal resources and land held in trust by the Federal Government, and limited its scope to bonds designed to foster employment opportunities on these tribal lands as part of the performance of this unique responsibility."¹⁷⁶

169. See 133 CONG. REC. S17,736 (Dec. 10, 1987) (Senate insists upon its amendment and requests a conference); 133 CONG. REC. S 17,818 (Dec. 11, 1987) (naming of Senate conferees); 133 CONG. REC. H11,268 (Dec. 11, 1987) (naming of House conferees). The House conferees included Representative Gibbons. *Id.*

170. John J. Doran, 22 *Senators Urge Bentsen to Oppose Legislation to Curb Indian Bond Power*, BOND BUYER, Dec. 14, 1987, at 6. The senators signing the letter were a bipartisan group, including Senators Daniel Inouye (D-Hawaii), John McCain (R-Ariz.), and Alphonse D'Amato (R-NY). *Id.*

171. *Id.*

172. *Id.* In order to ward off passage of the Gibbons amendment, the Bureau of Indian Affairs also began drafting regulations that would increase its role in deciding which tribal government projects could be funded with tax-exempt bonds. See Doran, *supra* note 170, at 1. Representative Gibbons's reported reaction was that "he would redouble his effort to get his amendment passed by the full Congress if the bureau instituted the regulations. Mr. Gibbons said the agency should not write regulations around an act of Congress." *Id.*

173. Pub. L. No. 100-203, § 10632(a), 101 Stat. 1330-455 (codified as amended at I.R.C. § 7871(e) (1993)).

174. Pub. L. No. 100-203, § 10632(b), 101 Stat. 1330-456 (codified as amended at I.R.C. § 7871(c)(3) (1988)).

175. The employment requirements are particularly onerous. They require that the aggregate amount of bonds outstanding at the end of any one year be not more than 20 times greater than the aggregate wages paid during the same year to enrolled members of the Indian tribe of the issuer. *Id.* § 7871(c)(3)(D). That is, if a tribal government issued \$20 million of bonds to build a manufacturing plant, the plant would have to have pay enrolled members of the tribe wages annually of at least \$1 million.

176. OMNIBUS BUDGET RECONCILIATION ACT OF 1987, CONFERENCE REPORT TO ACCOMPANY H.R. 3545, H.R. REP. NO. 495, 100TH CONG., 1ST SESS. 1012 (1987). No deals have been reported in the *Bond Buyer* under this provision.

This limited authority, however, did not authorize either tribal PABs or the off-reservation, leveraged buy-outs that tribal governments had been conducting. As a result of these statutory changes,¹⁷⁷ several planned tribal bond offerings had to be abandoned.¹⁷⁸ Reported tribal bond offerings came to a standstill for several years.¹⁷⁹

C. PROMPTING CONGRESSIONAL OVERSIGHT AND ACTION

Whatever the wisdom of the bond provisions in the Tribal Tax Act of 1982, a congressional coalition concluded that the Treasury regulations went beyond the original legislative intent. Yet, Congress became aware of this administrative error only because the press covered particular offerings. Moreover, the press covered the offerings only because of a possibility that the number and size of such offerings would increase substantially as a result of changes to the laws

177. Of course, the notion of "customary" in the amended statute is itself subject to interpretation. Congressional dissatisfaction with the generous interpretation of the IRS, however, was clearly expressed in the 1987 legislative history. This time the IRS heeded the implication. *Compare* Priv. Ltr. Rul. 85-27-064 (Apr. 10, 1985) (tribal enterprises including logging, farming, and retail sales were essential governmental functions exempt from excise tax) *with* Priv. Ltr. Rul. 90-13-002 (Apr. 9, 1990) (a tribal enterprise that does not perform an essential governmental function under amended § 7871 is not eligible for excise tax exemption).

178. The Rosebud Sioux of South Dakota gave up plans to finance the purchase of off-reservation multi-family housing units with tax-exempt bonds and the Navajo nation reconsidered plans to finance the purchase of a 491,000 acre ranch and a joint venture with Oleg Cassini to build a luxury resort on the reservation. Doran, *supra* note 141, at 1. Problems with the Navajo nation project, however, went far beyond the change in the tax law and involved an internal and federal investigation of the validity of the ranch purchase. John J. Doran, *Navajo Nation Postpones Sale of \$39 Million of Tax-Exempts*, BOND BUYER, Sept. 23, 1987, at 1. This offering was abandoned. John J. Doran, *Navajo Plans \$100 Million Issue, In an Effort to Sell Its First Muni Bonds*, BOND BUYER, Sept. 30, 1988, at 1.

179. The *Bond Buyer* reports no completed tribal government offerings after 1987. In August 1992, Carl Shaw, director of public affairs for the federal Bureau of Indian Affairs, told the *Bond Buyer* that "the bureau [is] not aware of any tax-exempt bond issuance on the part of tribes since the new law took effect." Karen Pierog, *Indian Tribes Come Back to Muni Market with Big Revenues from Casino Gambling*, BOND BUYER, Aug. 27, 1992, at 1.

Recently, isolated tribal bond offerings have taken place. In August 1992, the Mille Lacs Band of Chippewa Indians placed \$15 million of tax-exempt bonds backed by the revenues from its two casinos, which generate profits of \$750,000 a month. The proceeds were to be used to build a grade school, a high school, a health clinic and also for infrastructure improvements. *Id.* Casino gambling by tribal governments was authorized by the Indian Gaming Regulatory Act, 25 U.S.C. § 2701-21 (1988), and has proven lucrative for many tribes. *See supra* note 42. Revenues from gambling were not available at the time the Tribal Tax Act was passed. The Indian Gaming Regulatory Act was being considered by Congress at the same time as the 1987 amendments to the Tribal Tax Act, but there is no indication that either act influenced the other.

In September 1992, the Sault Ste. Marie Chippewa Indians Housing Authority placed a \$7.1 million tax-exempt bond issue, secured by the lease payments for the medical clinic to be built with the proceeds. *See supra* Pierog, at 1; Ethel Chamberlain & Kelly McCarthy, *Results of Negotiated Bond Sales*, BOND BUYER, Sept. 8, 1992, at 17.

In April 1993, the Confederated Tribes of the Warm Springs Reservation of Oregon offered \$3.75 million of bonds. It was the first tribal public offering and was secured by a direct-pay letter of credit provided by an Idaho bank as well as by the Tribes' pledge of general revenue-raising and taxing powers. The Tribes' revenue-raising powers include timber sales and payments in connection with operation of a hydroelectric project, but the letter of credit was considered necessary to give investors adequate security. The proceeds will be used to finance completion of a health center on the reservation. Dennis Walters, *Standard & Poor's Announces Its First Public Rating on Indian Bond Issue*, BOND BUYER, Apr. 30, 1993, at 1.

governing PABs. That is, limitations of nontribal PABs brought attention to tribal bonds that were not technically PABs, and congressional action took place, as it often does, as a result of anecdote or scandal. Members of Congress, in particular Representative Gibbons and the staff of the Joint Committee on Taxation, who apparently were not aware of the regulations when they were being promulgated, reacted to press reports. The legislative reaction condemned the regulations as inconsistent with the original legislative mandate.

Any delegation by Congress to an administrative agency risks the agency's departure from the preferences of the legislative coalition that passed the statute. The greater the delegation, the greater the need for mechanisms to ensure effective control by Congress. Standard political oversight of administrative agencies includes hearings, investigations, budget reviews, and legislative sanctions. Active oversight by Congress of administrative agencies, however, is costly and infrequent.¹⁸⁰ Congress is more likely to react to a blunder or departure from its intended policy, as happened in the case of tribal bonds, than to monitor the administrative process while the regulations are being formulated. An *ex post* reaction producing new legislation, however, is itself costly and cumbersome.¹⁸¹ We expect it to occur only if the agency diverges a great deal from the intent of members of the legislative coalition. Moreover, reactive legislation responds to a new status quo created by the administrative decision. In this case, legislators reacted not only to the regulations permitting tribal bonds to be used for economic development, but also to the issuance of bonds for off-reservation activities designed to raise revenue. Thus, as recent scholarship by McCubbins, Noll and Weingast observes, "the outcome of a legislative attempt to rectify an act of noncompliance by an agency will not, in general, reproduce the policy outcome that was sought by the winning coalition, even if the preferences of the members of the legislative body remain unchanged."¹⁸² Here, for example, the new status quo may have produced the stringent limits on tax-exempt bonds issued to build on-reservation manufacturing facilities.

Methods that assure administrative compliance but do not require active oversight by Congress or new legislation would avoid these costs. As McCubbins, Noll and Weingast explain, "An alternative [to investigative oversight] is to set up a system in which someone else (that is, a third party outside of the principal-agent diad) monitors the agent and reports acts of noncompliance."¹⁸³ McCubbins, Noll and Weingast believe that administrative procedures provide this alternative mechanism. They argue that administrative procedures, by stacking the deck to benefit favored political interests, by mirroring the political environment faced by the agency's overseers, and by encouraging those affected by the agency

180. See U.S. SENATE, COMM. ON GOVERNMENT OPERATIONS, 95TH CONG., 1ST SESS., STUDY ON FEDERAL REGULATION, VOL. II: CONGRESSIONAL OVERSIGHT OF REGULATORY AGENCIES ix-x (Comm. Print 1977).

181. However, it is less costly in tax than many other areas, because Congress so frequently passes tax bills. See Doernberg & McChesney, *supra* note 139.

182. McCubbins et al., *Structure and Process*, *supra* note 16, at 433.

183. *Id.* at 434; see McCubbins et al., *Administrative Procedures*, *supra* note 16, at 243.

to sound "fire alarms," reduce the need for Congress to impose sanctions. In developing their theory, these scholars emphasize formal rulemaking and such special administrative requirements as mandating that the administrative agencies consult with advisory committees. Nonetheless, they include informal—or "notice and comment"—rulemaking, such as that used here, within their framework.¹⁸⁴ They explain that these requirements of the Administrative Procedure Act have several political implications. The notice requirement ensures that agencies cannot present elected officials with a *fait accompli*, but must announce its intentions to consider an issue. By seeing which groups comment, agencies learn who are the relevant political interests. The record compiled by the administrative agency is available to Congress and thus overcomes informational inequalities between members of Congress and the administrative officers. Perhaps most importantly, "the entire sequence of decisionmaking . . . afford[s] numerous opportunities for political principals to respond when an agency seeks to move in a direction that officials do not like."¹⁸⁵ Constituencies effected by the agency's policies will sound a "fire-alarm" to get members of Congress to respond before an agency is fully committed to a policy. "A fire alarm converts the oversight job of a politician from active monitor to reactive servant of affected constituencies."¹⁸⁶

This case study of tribal bonds, however, exposes a significant constraint on the McCubbins-Noll-Weingast hypothesis.¹⁸⁷ The developers of this hypothesis assume that the object of legislation is to deliver benefits to the policy's target group, and they address only administrative action that harms the target group. The hypothesis fails to consider situations, such as the one described here, when some members join the coalition in order to limit benefits to the target group and the administrative agency nonetheless responds with generous regulations.

Those members of Congress who wish to limit the benefits for the regulated party cannot find solace in the regulatory process as envisioned by McCubbins,

184. McCubbins et al., *Administrative Procedures*, *supra* note 16, at 257–58. Under the Administrative Procedure Act, an agency engaging in informal rulemaking must give public notice of a proposed rule and allow any interested person to provide written comments on that rule. 5 U.S.C. § 53 (b), (c) (1988). The IRS follows the requirements of informal rulemaking, although it asserts that it is not bound to do so. The announcement of the proposed section 7871 regulations included the IRS's standard language to this effect: "Although this document is a notice of proposed rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretive and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply." 49 Fed. Reg. 19,329, 19,330. In contrast to informal rulemaking, formal rulemaking involves additional procedures, that include holding substantive hearings in which members of the agency may be sworn, examined, and cross-examined. 5 U.S.C. §§ 556–57. Formal rulemaking is required by the Administrative Procedure Act if the agency-enabling legislation requires rules to be made "on the record after opportunity for an agency hearing." 5 U.S.C. § 553(c).

185. McCubbins et al., *Administrative Procedures*, *supra* note 16, at 258.

186. McCubbins et al., *Structure and Process*, *supra* note 16, at 434.

187. For other criticisms of this hypothesis, see Michael Asimow, *On Pressing McNollgast to the Limits: The Problem of Regulatory Costs*, 57 LAW & CONTEMP. PROB. 125 (1994); Jeffrey S. Hill & James E. Brazier, *Constraining Administrative Decisions: A Critical Examination of the Structure and Process Hypothesis*, 7 J.L. ECON. & ORG. 373 (1991); Craig N. Oren, *Clearing the Air: The McCubbins-Noll-Weingast Hypothesis and the Clean Air Act*, 9 VA. ENVTL. L.J. 45 (1989); Glen O. Robinson, *Commentary on "Administrative Arrangements and the Political Control of Agencies": Political Uses of Structure and Process*, 75 VA. L. REV. 483 (1989).

Noll and Weingast. The private parties monitoring the regulatory process because of its impact on them will not sound a fire alarm when soothing waters flow from the regulators.¹⁸⁸ Moreover, given the strong possibility that regulators will favor the regulated party, the dice of policy lottery will be loaded against the less lenient legislators and monitoring becomes all the more necessary. These members of Congress will need to be active monitors and not reactive servants of the regulated interests.

In this case, language in the Conference Committee Report did not forestall the influence of the regulated parties in developing the regulations. Additional action was needed. The action here could have been informal—Representative Gibbons could have had congressional staff—whether a member of his own staff, the staff of the Ways and Means Committee, or the Joint Committee on Taxation—monitor development of the regulations and represent his point of view in the administrative process.

In other cases, where the stakes are high for legislators who wish to limit the benefits, more formal oversight may be appropriate.¹⁸⁹ If a sufficiently strong bloc of the legislative coalition fears that the absence of competing interests will result in lenient regulations, the legislation can include a requirement that the administrative agency report on the actions it takes.¹⁹⁰ In some cases, the legislation could establish an advisory committee or panel of private parties to monitor the agency's

188. In some cases, potential competitors of the favored parties will monitor the regulatory process. For example, owners of small businesses and the agency that represents them spearheaded the efforts for Congress and the IRS to review the rules that tax the unrelated business income of exempt organizations. See OFFICE OF THE CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION, *UNFAIR COMPETITION BY NONPROFIT ORGANIZATIONS WITH SMALL BUSINESS: AN ISSUE FOR THE 1980s* 37–40 (3d ed. 1984). The Subcommittee on Oversight of the House Ways and Means Committee held a series of hearings on the issue, without producing legislation. See Aprill, *supra* note 30, at 466–68. When, however, as here, potential competitors—be they governments, private parties looking to acquire their own cement factories, or casinos—do not see the regulations as having a significant impact, neither will they undertake oversight for members of the congressional coalition. That is, it is possible that private party oversight did not operate here because the dollars involved and impact were expected to be small. When such an expectation changes, the fire alarm is sounded. In such a case, however, the status quo has changed. Moreover, it represents an *ex post* response. The focus here, as in the work of McCubbins, Noll, and Weingast, is how Congress can assure agency fidelity to the original delegation *ex ante*. Representative Gibbons's letter to Treasury Secretary Baker and the legislative history of the 1987 amendments express a concern with divergence from the original legislation, not with later developments. That is, the response was not simply to change the law so that the regulations would no longer be valid—a common congressional response—but to declare the regulations invalid.

189. Insofar as such oversight decreases administrative discretion, of course, it may upset the coalition needed to pass the legislation. As a procedural rather than a substantive check, however, it requires less consensus than specific legislative language.

190. The very act of writing a report will impose discipline and make compliance with the balance struck by the legislative coalition more likely. Had Treasury been required to describe the § 7871 regulations in a report to Congress, the interpretive implications of the legislative history regarding "essential governmental function" would have been difficult to ignore. Regulations might have been less generous, perhaps requiring bonds be used on-reservation and generate tribal employment, and less likely to have been overturned by later legislative action. See Karla W. Simon, *Congress & Taxes: A Separation of Powers Analysis*, 45 U. MIAMI L. REV. 1005, 1045–47 (1991), for examples of congressional oversight in the tax area.

action.¹⁹¹ When circumstances are such that an administrative agency is unlikely to weigh one of the contending points of view that produced the legislative decision, members who hold that view will have to act to ensure that the agency does so.

V. Conclusion

Very different versions of the tribal bond saga are plausible. The congressional coalition may have reached a balance designed to acknowledge tribal sovereignty while at the same time protecting the federal fisc and the tribes from rent-seeking by private promoters. Under such a view, the Treasury and the IRS upset this balance by deferring to the tribal governments in writing the regulations. Under another view, less noble concerns, such as personal pique or prejudice, strongly influenced the congressional compromise. Because the compromise relied on ambiguous language, the administrative agency, by permitting tribal governments to engage in economic development, was able to interpret the statute to promote the public interest in encouraging economic development by tribal governments.

Thus, this case history shows the difficulty in distinguishing public interest from special interest and independent judgment from capture. Which story is most persuasive depends on the choice of both positive theories regarding congressional and agency motivation and on normative theories regarding the place of tribal governments and the purpose of tax-exempt bonds. Of course, a single case study does not a positive theory make. However, this case study shows how difficult it is to ground positive theories empirically. Much of the empirical data will, like the facts here, be uncertain and difficult to categorize.

Under either view of the tribal bond saga, this case study demonstrates the complications that follow from congressional use of broad and ambiguous statutory language, however necessary or inevitable such language may be. Ambiguity resulting from a compromise of conflicting points of view may produce legislation with little content or impact. More generally, broad statutory language increases the discretion of the agency administering the statute. In this case, even language in the legislative history suggesting that the statute be interpreted narrowly did not prevent the Treasury Department from promulgating generous regulations that favored the tribal governments. Subsequent congressional action made clear that an important segment of the congressional coalition preferred a strict interpretation of the broad language of the original legislation. This preference was strong enough to motivate these members of Congress to amend the statute.

Lessons for both members of Congress and administrative agencies emerge from this case study. The IRS and the Treasury Department, by accepting the views of the tribal governments and ignoring the tenor of the legislative history, experienced the sanction of sharply critical language in subsequent legislative history. This case study thus cautions administrative agencies to pay attention

191. That is, depending on who is appointed to serve, the same procedures that the McCubbins-Noll-Weingast hypothesis suggests will favor the regulated parties could serve to limit the benefits to them.

to legislative history, at least in the form of committee reports. It suggests that members of Congress expect administrative agencies to attend closely to legislative history in interpreting legislative language. The study also cautions Congress. Members of the original congressional coalition, by relying on ambiguous language in the legislative history instead of maintaining oversight of an administrative process that tends to favor the regulated party, were forced to take ex post action and amend the statute. This case study demonstrates that members of the legislative coalition who wish to prevent lenient regulations cannot depend on participants in the administrative process to sound fire alarms; they must formally or informally arrange for such oversight themselves.

Amendment of the tribal bond provisions proved costly not only for the resources of the Congress, but also for the opportunities of the tribal governments. It resulted in a statute that strictly limits the tribe's ability to issue bonds for on-reservation economic development. Thus, congressional oversight of the broad administrative discretion would have worked to the advantage of both members of Congress and the tribal governments. Here, both Congress and the administrative agency may have relied too greatly on the targeted group in the administrative process. Yet, the members of that group, the tribal governments, were the ones that bore the cost of any excessive reliance.