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Via E-mail

August 24, 2016

Legislative Budget & Audit Committee
Alaska State Legislature
State Capitol, Room 514
Juneau, Alaska 99801

Re: Federal Income Tax Issues Raised by the AGDC – AKLNG Concept Document and the Heads of Agreement Regarding the Company Contemplated by the Project Documents to Be Formed by the Alaska Gasline Development Corporation

Our File No. 12463-02

Ladies and Gentlemen:

In a contract dated August 24, 2016, the Legislative Budget & Audit Committee of the Alaska State Legislature (the "Committee") has requested that Manley & Brautigam P.C. provide advice to the Committee concerning Federal income tax issues raised by the July 2016 AGDC – AK LNG Concept Document (the "Concept Document") and the January 14, 2014 Heads of Agreement (altogether, the "Project Documents"). This letter addresses certain federal income tax issues raised by the contemplated organization by the Alaska Gasline Development Corporation ("AGDC") of a company that would own, commercialize, finance, design, build and operate a gas treatment plant on the North Slope of Alaska with gas transmission lines from producing units, an approximately 800 mile long gas pipeline, and a liquefaction plant and marine terminal located near Nikiski, Alaska (the "Project").

This letter is issued in conjunction with a separate contract between the Committee and Jermain, Dunnagan & Owens, P.C. regarding tax-exempt financing issues raised by the Project Documents.

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I. AGDC and its Enabling Legislation.

The purpose of the Project, as contemplated by AS 31.25.005, includes developing natural gas pipelines, to deliver natural gas in-state for the maximum benefit of the people of Alaska, to provide economic benefits and revenue to the State, and to maximize royalty and tax revenues from Alaska natural gas.

The State's interest in the Project would be held, directly or indirectly, by AGDC,

> a public corporation and government instrumentality acting in the best interest of the state for the purposes required by AS 31.25.005, located for administrative purposes in the Department of Commerce, Community, and Economic Development, but having a legal existence independent of and separate from the state.

AS 31.25.010.

AGDC is governed by a board of directors consisting of five public members, appointed by, and serving at the pleasure of, the governor and subject to confirmation by the legislature and two individuals designated by the governor that are each the head of a principal department of the State (other than the commissioner of natural resources and the commissioner of revenue). AS 31.25.020. The AGDC board may appoint a program director for the Project and shall appoint an executive director for AGDC. AS 31.25.040(d) and 31.25.045. The personnel of AGDC are exempt from AS 39.25, the State Personnel Act. AS 31.25.065.

AGDC has been granted the power of eminent domain, exercisable by filing a declaration of taking under AS 09.55.240 - 09.55.460, to acquire land or an interest in land that is necessary for the Project; the exercise of powers by AGDC may not exceed the permissible exercise of the powers by the State. AS 31.25.080(a)(4).

The board of AGDC has been granted the power to "adopt regulations to carry out the purposes of [AS 31.25]"). AS 31.25.130(c). AGDC is generally required to post proposed regulations for public comment at least 15 days prior to adoption. AS 31.25.130(d). Regulations adopted by AGDC's board shall be made available to members of the public and to the chair of the Administrative Regulation Review Committee under AS 24.20.400-24.20.460. AS 31.25.130(a).

AGDC has been given access by statute to the information of departments, agencies, and public corporations of the State that is directly related to the planning, financing, development, acquisition, maintenance, construction, or operation of the Project. All departments, agencies, and public corporations of the State are required to cooperate

with, and provide information, services, and facilities to AGDC, and are generally required to give priority to processing authorization applications and other requests of AGDC. Further, the Department of Natural Resources is generally required to grant AGDC a right-of-way lease under AS 38.35 for the Project's gas pipeline transportation corridor at no appraisal or rental cost. AS 31.25.090.

Alaska Statutes 31.25.110 authorizes a Project fund, established in AGDC and consisting of money appropriated to it. AGDC would be responsible for fund management, but may contract with the Department of Revenue for fund management. If money were appropriated to the fund to finance the cost of the Project, AGDC would create an account in the fund for that purpose and hold the money appropriated for that purpose in that account. AGDC may use money appropriated to the fund without further appropriation for the purpose of managing the fund, for purposes related to the Project, and for purposes of transferring net revenue received by AGDC related to equity interest, contracts, and other activities to an appropriate fund as determined by the commissioner of revenue in consultation with the commissioner of natural resources.

II. Analyzing the Tax Status of AGDC Itself.

A. The Case for AGDC Qualifying as a Political Subdivision of the State of Alaska.

If AGDC qualifies as a political subdivision of the State of Alaska for tax purposes, its income would not be subject to federal taxation, under the doctrine of implied statutory immunity.

> Income earned by a state, a political subdivision of a state, . . . is generally not taxable in the absence of specific statutory authorization for taxing such income.

Rev. Rul. 87-2 (emphasis added).

The income of states and their political subdivisions is exempt from federal taxation because, with one exception,[1] the Internal Revenue Code does not expressly impose a tax on them. States and their political subdivisions are protected by implied statutory immunity, implied from the failure of the Internal Revenue Code to either expressly subject them to,

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[1] Namely, IRC § 511(a)(2)(B) imposes the unrelated business income tax on state colleges and universities.

or exempt them from, federal income taxation.[2] *E.g.*, Rev. Rul. 87-2; *Estate of Alexander J. Shamberg*, 3 T.C. 131, 146 (1944), *acq.*, 1945 C.B. 6, *aff'd*, 144 F.2d 998 (2d Cir. 1944), 1945 C.B. 335, *cert. denied*, 323 U.S. 792 (1944).

A political subdivision is a division of the state which has been delegated the right to exercise part of the powers of a sovereign. *Id.* Sovereign powers include the power to tax, the power of eminent domain, and the police power. Rev. Rul. 77-164; *Estate of Shamberg*.

The first case to analyze the sovereign powers that a state or local subdivision must have to establish implied statutory immunity from federal taxation was the *Estate of Shamberg*, which concerned the Port of New York Authority ("Port Authority"). *Estate of Shamberg* is particularly relevant, as the structure of the Port Authority resembles in key respects the structure of AGDC. Specifically, the Port Authority was

> endowed with the power of eminent domain, and with certain police powers, including the promulgation and enforcement of regulations for the conduct of navigation and commerce in the area defined as the Port of New York District.

Estate of Shamberg, 3 T.C. at 143.

AGDC likewise has the same two of the three sovereign powers, namely the power of eminent domain and certain police powers. First, AS 31.25.080(a)(4) provides that AGDC has the power of eminent domain. Second, AGDC has significant police powers–AS 31.25.130(c) provides that the board of AGDC "may adopt regulations to carry out the purposes of [AS 31.25]").

AGDC's power under AS 31.25.130(c) to "adopt regulations to carry out the purposes of [AS 31.25]" is an example of a police power, one of the sovereign powers that can qualify AGDC as a political subdivision (and correspondingly exempt it from taxation). The police power

> embraces regulations designed to promote the public convenience or the general prosperity, as well as regulations

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[2] Implied statutory immunity is different from the constitutional doctrine of intergovernmental tax immunity, which formerly provided substantial protection to states and their political subdivisions from federal taxation. However, the Supreme Court of the United States has in recent decades held that states and their political subdivisions have no broad constitutional protection from federal taxation. *E.g.*, *New York v. United States*, 326 U.S. 572 (1946), and *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985).

> designed to promote the public health, the public morals or the public safety.

Philadelphia Nat'l Bank v. U.S., 666 F.2d 834, 840 (3d Cir. 1981), *cert. denied*, 457 U.S. 1105, 73 L. Ed. 2d 1314, 102 S. Ct. 2904 (1982) (quoting *Chicago, Burlington & Quincy Ry. Co. v. Illinois ex rel Drainage Comm'rs*, 200 U.S. 561, 592 (1906)).

Estate of Shamberg found that the Port Authority's police powers included "the promulgation and enforcement of regulations for the conduct of navigation and commerce in the area defined as the Port of New York District." As discussed above, AS 31.25.130(c) authorizes AGDC to "adopt regulations to carry out the purposes of [AS 31.25]" Further, AS 31.25 authorizes AGDC to build and own an interest in feeder and transmission natural gas pipelines, and a related LNG plant and marine terminal. In sum, the regulatory power under AS 31.25.130(c) is similar to the regulatory power held by the Port Authority at issue in *Estate of Shamberg*.

All three sovereign powers need not be delegated for AGDC to qualify as a political subdivision for purposes of § 103. Rev. Rul. 77-164, citing *Estate of Shamberg*, states that:

> Three generally acknowledged sovereign powers of states are the power to tax, the power of eminent domain, and the police power . . . . It is not necessary that all three of these powers be delegated. However, possession of only an insubstantial amount of any or all sovereign powers is not sufficient."

(Emphasis added.)

IRS private letter rulings routinely grant political subdivision status to entities that have only one of the three sovereign powers, such as a library district with the power of taxation, a school district with the power of eminent domain, or a health care authority with the power of eminent domain. Ellen P. Aprill, The Integral, the Essential, and the Instrumental: Federal Income Tax Treatment of Governmental Affiliates, *23 Iowa J. Corp. L. 803, 808-9 (1998)*.

If AGDC intends to qualify for federal tax exemption under implied statutory immunity, it is essential that AGDC retain substantial police (i.e., regulatory) powers under AS 31.25.130(c), in addition to the power of eminent domain. General Counsel Memorandum 37,771 noted that:

> Whatever doubt exists as to exactly what constitutes the minimum amount of required "sovereign power" this Office is unprepared to concede that the possession of only one sovereign power is sufficient. We arrive at this conclusion after considering that the enumerated sovereign powers (taxation,

> eminent domain, police) can exist in an entity in only a minor degree and recognizing that all the facts and circumstances must be taken into consideration, including the public purposes of the entity and control of the entity by a government.

(Citing *Gen. Couns. Mem. 36,994*, at 7-8.]

Revenue Ruling 73-563 held that a rapid transit authority qualified as a political subdivision under Treas. Reg. 1.103-1 for purposes of issuing tax-exempt bonds because the authority, in part because it had the police power to set rates, determine routes, and enforce its regulations by maintaining a security force, but also because the state legislature empowered participating state governing bodies to levy retail and use taxes to fund the authority and authorized them to exercise the power of eminent domain on behalf of the authority.

Further, AS 31.25.090(a) provides AGDC with access to information of State departments, agencies, and public corporations directly related to the planning, financing, development, acquisition, maintenance, construction, or operation of the Project. All State departments, agencies, and public corporations are required by AS 31.25.090(a) to cooperate with, and provide information, services, and facilities to AGDC, and are generally required to give priority to processing authorization applications and other requests of AGDC. Finally, AS 31.25.090(d) generally requires the Department of Natural Resources to grant AGDC a right-of-way lease under AS 38.35 for the Project's gas pipeline transportation corridor at no appraisal or rental cost.

There is language in AS 31.25 that suggests that AGDC is not a political subdivision of the State. First, AS 31.25.240 states that obligations issued under AS 31.25 are not debts of "the state or of a political subdivision of the state,"[3] implying that AGDC is not a political subdivision. Second, AS 31.25.010 states that AGDC is an instrumentality of the State. As discussed below in the section on instrumentalities, an "instrumentality" for federal tax purposes is by definition something other than a state or a political subdivision of the state. In order to qualify for tax exemption under implied statutory immunity, AGDC will need to prove that it is, in fact, a political subdivision of the State regardless of the language in AS 31.25.010, and is not an instrumentality for federal tax purposes. Specifically, AS 31.25.010 provides that AGDC is

> a public corporation and government instrumentality acting in the best interest of the state for the purposes required by AS 31.25.005, located for

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[3] Note that AS 31.25.240 does not say that obligations issued under AS 31.25 are not debts of "the state or of another political subdivision of the state," etc.

> administrative purposes in the Department of Commerce, Community and Economic Development, but having a legal and existence independent of and separate from the state.

AS 31.25.010.

Treasury Regulation § 301.7701-1(a)(3) provides that an entity that is separate from a state or political subdivision "is not always recognized as a separate entity for federal tax purposes."[4] For instance, the Second Circuit held in *Estate of Shamberg* that the Port Authority of New York qualified as a political subdivision, even though the Port Authority's authorizing statutes provided, similar to AS 31.25.010 describing AGDC as a "public corporation and instrumentality," that the Port Authority is

> a body politic and corporate[5] created by a compact made between the States of New York, [**5] Laws N.Y. 1921, c. 154, and New Jersey on April 30, 1921, N.J.S.A. 32:1-1 et seq., and approved by Congress on August 23, 1921, 42 Stat. 174.

Estate of Shamberg at 1000 (emphasis added). See also Rev. Rul. 70-562 (finding that a county board of education, described as an instrumentality of the state, qualified as a political subdivision–an acceptable charitable donee under § 170(b)(1)(A)).

More recently, the Service ruled in PLR 201142016 that: (1) a public utility (described as the Authority), analogous to AGDC, qualified as a political subdivision of the Territory and, as such, was not subject to federal income taxation; and (2) the income derived from the operations of the limited liability companies owned by the Authority (created to develop, finance, construct, and operate industrial projects and other infrastructure directly related to maximizing the Authority's electric infrastructure) was excluded from gross income pursuant to § 115(2) of the Internal Revenue Code (based upon representations that private interests neither materially participated in nor benefitted more than incidentally from the operations of the Authority.

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[4] Adding, by way of example, that "an organization wholly owned by a State is not recognized as a separate entity for federal tax purposes if it is an integral part of the State."

[5] AGDC is similarly described as a "body corporate and public" in AS 31.25.260(b), dealing with the tax exempt status of its bonds. Note that PLR 8934052, which failed to cite Treas. Regs. § 301.7701-1 & -2, found that a community arts council was "not an integral part of a political subdivision because it is a separate entity created under a State statute that makes it a separate body "corporate and politic." But see PLR 9822011, which cited the regulation, found the corporation organized by the state as a "body politic and corporate" was an integral part of the state.

> When a state or political subdivision conducts an enterprise through a separate entity . . . the income of the entity may be exempt or excluded from income under a specific provision such as section 501 and section 115.

The rules governing tax exemption under § 115 are discussed further below.

For ruling purposes, to determine whether AGDC qualifies as a political subdivision of the State, and under implied statutory immunity is not subject to federal income taxation, the IRS has in recent years begun to apply the Treasury regulations interpreting § 103 of the Internal Revenue Code. Rev. Rul 77-164; see also PLR 201142016. Under Treas. Reg. § 1.103-1(b), a "political subdivision" refers to "any division of any State or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit."

On February 23, 2016, the IRS issued Proposed Regulations on the definition of political subdivision for purposes of whether bonds are exempt from federal taxation under §103. In doing so, the IRS advances an interpretation of what it means to be a political subdivision that goes beyond the well-settled law reflected in the holding of the *Estate of Shamberg*. Namely, the proposed regulations, if they become final, add a new subsection (c) to Treas. Reg. § 1.103–1, providing that an entity can only be considered a political subdivision for purposes of issuing tax-exempt bonds under § 103 if the entity: (a) has one or more sovereign powers, as required by the holding of the *Estate of Shamberg*, and (b) has a governmental purpose, and (c) is governmentally controlled.

Under Prop. Treas. Reg. § 1.103-1(c), if it becomes a final regulation, to qualify as a political subdivision for purposes § 103, an entity would need to serve a governmental purpose, which requires a showing that it: (1) carries out the public purposes set forth in the entity's enabling legislation, (2) operates in a manner that provides a significant public benefit and (3) provides no more than an incidental private benefit.

Alaska Statutes 31.25.260(a) states the public purposes of AGDC, namely that the entity shall exercise its powers for the benefit of the people of the State of Alaska, for their well-being and prosperity, and for the improvement of their social and economic conditions. Further, AS 31.25.260(b) states that obligations of AGDC would be issued "for an essential public and governmental purpose." As discussed further below, there is an issue as to whether AGDC's involvement in the Project might provide more than an incidental private benefit.

Under Prop. Treas. Reg. § 1.103-1(c), if it becomes a final regulation, to qualify as a political subdivision for purposes § 103, a state or local governmental unit must exercise control over the entity. Control is defined in Prop. Treas. Reg. § 1.103-1(c)(4)(I) as meaning an ongoing right or power to direct significant actions of the entity, including the

right or power to elect a majority of the governing body of the entity in periodic elections of reasonable frequency.

The governing body provisions of AS 31.25.020 appear to satisfy Prop. Treas. Reg. § 1.103-1(c)'s definition of control. The statute provides that the Governor designates or appoints five public members, and two individuals who each are a head of a principal department of the state, and, in the case of the public members, subject to confirmation by the legislature.

As discussed further below, Prop. Treas. Reg. § 1.103-1(c) seems to represent the Treasury's attempt to extend its informal ruling position for private letter rulings under § 103, the Code section authorizing the issuance of tax-exempt bonds by states and their subdivisions, to areas beyond the actual scope of § 103.

If AGDC intends to rely on implied statutory immunity as a political subdivision of the State to establish its claim to exemption from federal income taxation, AGDC is strongly recommended to secure a private letter ruling confirming that AGDC qualifies for tax exemption under implied statutory immunity.[6]

B. The Case for AGDC being an Integral Part of the State.

If AGDC did not qualify, or if the IRS were not willing to issue a private letter ruling confirming that AGDC qualifies, for tax exemption under implied statutory immunity as a political subdivision of the State, the question would then be whether AGDC qualifies for tax exemption as an integral part of the State or a political subdivision of the State.

Alaska Statutes 31.25.010 provides that AGDC is a:

> public corporation and government instrumentality acting in the best interest of the state for the purposes required by AS 31.25.005, located for administrative purposes in the Department of Commerce, Community, and Economic Development, but having a legal existence independent of and separate from the state.

(Emphasis added.)

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[6] Any private letter ruling issued by the Serviced is premised on the accuracy of the representations made in seeking the private letter ruling. For instance, to establish that an entity serves a governmental purpose, Prop. Treas. Reg. § 1.103-1(c)(3) requires that the entity in fact carries out the public purposes that are set forth in the entity's enabling legislation and that the entity in fact operates in a manner that provides a significant public benefit with no more than incidental private benefit. These requirements make clear that the effectiveness of a private letter ruling depends on the actual operations of the organization that owns, develops and operates the Project being consistent with the representations made in seeking the private letter ruling.

Alaska Statutes 31.25.260(b) further provides that all obligations issued under AS 31.25, namely by AGDC, are declared to be issued by a:

> body corporate and public of the state and for an essential public and governmental purpose, . . .

(Emphasis added.)

This corporate separation raises the issue whether AGDC would be treated as a taxable corporation under federal law, separate from the State of Alaska, which is not subject to federal taxation. A corporation is generally treated as separate from its shareholders for tax purposes. *Moline Props., Inc. v. Comm'r*, 319 U.S. 436, 438-439 (1943).

Whether AGDC qualifies as an integral part of the State turns on whether its corporate status would prevent AGDC from being treated as an integral part of the State for tax purposes.

> Over the years, the IRS has extended the income tax exemption it provides to states and political subdivisions to entities it regards as their "integral parts." See Rev. Rul. 87-2, 1987-1 C.B. 18; *see also* Treas. Reg. § 301.7701-1(a)(3).

IRS Announcement 2011-78, n. 24, 2011-51 I.R.B. 874 (12/19/2011) (emphasis added).

Revenue Ruling 87-2 provides that:

> Income earned by . . . an integral part of a state or political subdivision of a state is generally not taxable in the absence of specific statutory authorization for taxing such income.

(Emphasis added).

In other words, even if AGDC failed to have any sovereign power qualifying it as a political subdivision of the State, AGDC could still be exempt from federal income tax if it is an integral part of the State or one of its political subdivisions.

Although AS 31.25.010 states that AGDC is a corporation "having a legal existence independent of and separate from the state," Treas. Reg. § 301.7701-1(a)(3) provides that AGDC's corporate status should not prevent AGDC from being treated as an integral part of the State for tax purposes:

> an organization wholly owned by a State is not recognized as a separate entity for federal tax purposes if it is an integral part of the State.

Treasury Regulation § 301.7701-1(a)(3) indicates that the corporate separation of AGDC can be ignored for tax purposes if AGDC is an integral part of the State. The accompanying regulation, Treas. Reg. §301.7701-2(b)(1) & (6), seems to say that a corporation such as AGDC will, if it is not an integral part of the State, be taxed as a separate corporation.

> For federal tax purposes, the term corporation means–(1) A business entity organized under a Federal or State statute, . . . if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic; (6) A business entity wholly owned by a State or any political subdivision thereof . . ..

Id.

Treasury Regulations § 301.7701–1 & –2 provide no guidance regarding the circumstances that will cause a corporation wholly owned by a state or a political subdivision to be considered an integral part of the state. Some private letter rulings[7] issued shortly after the promulgation of Treas. Regs. § 301.7701-1 & -2 cited that regulation in ruling that, while the corporation may be classified as an entity separate from the state, that the corporation was an integral part of the state, and thus qualified for federal exemption.

The Tax Court recently addressed whether a corporation organized under Delaware law was, analogous to Treas. Reg. § 301.7701-1(a)(3), an integral part of an Indian tribe and thus exempt from federal taxation. *Uniband Inc. v. Comm'r*, 140 TC 13 (2013). The Tax Court in *Uniband* ultimately found that Uniband was organized as a state law business corporation and not under tribal law, that Uniband's constituent documents did not guarantee tribal control of Uniband, that Uniband appeared to have financial autonomy from the tribe, and held that Uniband was not an integral part of the tribe and was thus subject to federal taxation.

Private letter rulings in recent years addressing whether a corporation formed by a state, like AGDC, qualifies for federal tax exemption as an integral part of the state or political subdivision generally do not cite Treas. Regs. § 301.7701-1 & -2, but rather look to whether (a) there is sufficient state control over the entity and (b) whether the state has

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[7] PLRs 9822011 and 9852018. A private letter ruling is only binding on the taxpayer(s) who requested the ruling; they are nonetheless a useful indication of how the IRS would rule on a specific transaction. The only published ruling in this area, Rev. Rul. 87-2, concerned a lawyer trust account fund created by order of the state supreme court that was not an independent entity. Taxpayers are entitled to rely on revenue rulings (such as Rev. Rul. 87-2), which are an official interpretations of the tax law on specific transactions published by the national office of the Internal Revenue Service.

made a financial commitment to fund the corporation. E.g., *Non Profit Ins. Program v. United States* (E.D. Wash. 2016), PLR 200524015.

The State would control AGDC by controlling its board of directors, consisting of members appointed by, and serving at the pleasure of, the governor and subject to confirmation by the legislature and individuals designated by the governor that are each the head of a principal department of the State. AS 31.25.020.

The State would be making a substantial financial commitment to fund AGDC, and would be controlling its finances. First, as noted immediately above, the State would maintain board control of AGDC. AS 31.25.020. Second, AS 31.25.110 provides that AGDC could only transfer revenues that it has received to an appropriate fund as determined by the commissioner of revenue in consultation with the commissioner of natural resources.

Private letter rulings holding that an enterprise or organization qualifies as an integral part of the state for tax purposes use the same analysis and cite substantially the same authorities, regardless whether the enterprise or organization was formed as a corporation. Namely, they each cite[8] Rev. Rul. 87–2 as establishing that income earned by an enterprise that is controlled by the state and is an integral part of the state is not generally subject to federal taxation, and cite *Maryland Savings-Share Insurance Corp. v. United States*, 308 F.Supp. 761, *rev'd on other grounds*, 400 U.S. 4 (1970), for the proposition that, in order to qualify as an integral part of the state, the state must have made a sufficient financial commitment to the enterprise as well as maintained sufficient state control over the enterprise.[9]

For instance, PLR 200403026 held that a hospital was as an integral part of a city for federal income tax purposes. The ruling found that the city had substantial control over

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[8] Of the private letter rulings discussed immediately below, PLR 200403026 and 200427016 also cite Treas. Reg § 301.7701-1(a) as providing that an organization wholly owned by a state is not recognized as a separate entity for federal tax purposes if it is an integral part of the state.

[9] Each of the private letter rulings listed immediately below also distinguishes *Michigan v. United States*, 802 F. Supp. 120, 127 (W.D. Mich. 1992), rev'd, 40 F. 3d 817 (6th Cir. 1994), which the Service believes is a flawed opinion that misapplied Rev. Rul. 57–128. (Professor Aprill also criticizes the *Michigan* opinion, concluding that "[i]n treating the trust as exempt, the majority confused and misapplied the tests for political subdivision, instrumentality, and integral part." *23 Iowa J. Corp. L. at 825.)* While the *Michigan* analysis was recently adopted by the Tax Court in *Uniband Inc. v. Comm'r* (holding that a corporation organized under Delaware law was not an integral part of an Indian tribe), the Service's long-standing refusal to acquiesce in the *Michigan* opinion means that the Service likely will continue to issue private letter rulings that conform to its current ruling position based on Rev. Rul. 87–2 and *Maryland Savings-Share*, namely that State control and financial commitment are necessary to establish that an enterprise is an integral part of the State.

the hospital (all of the members of the board were appointed by the mayor and subject to approval of the city commissioners; and the hospital's annual budget and audit were reviewed annually by the city commission). The ruling found that the city had made a substantial financial commitment to the hospital (the city contributed the hospital facilities and the land on which the facilities are located; and the city contributed cash and bond proceeds, including the proceeds from general obligation bonds, for the acquisition of additional land and the construction and renovation of the hospital facilities).

PLR 200136011 held that an authority, created by state statute to encourage commercial space flight from the state by promoting research and participating in the development of a commercial flight center, was as an integral part of the state for federal income tax purposes. The ruling found that the state had substantial control over the authority (of the authority's twelve directors, four were public officials and eight were appointed by the governor, subject to approval by both houses of the state legislature; the authority is required by statute to submit a detailed initial plan for the use of general funds appropriated for the authority to the governor and the state legislature, and the authority is required to submit an annual report and financial statement to the governor and the state legislature). The ruling also found that the state had made a substantial financial commitment to the authority by contributing moneys to the authority.

PLR 200427016 held that a non-profit public corporation, formed by the state legislature to operate insurance plans that function exclusively as residual market mechanisms to provide essential property insurance for residential and commercial property, was as an integral part of the state for federal income tax purposes. The ruling found that the state had substantial control over the corporation (the directors include public officials and their designees, and members appointed by the commissioner or governor, all senior management serve at the commissioner's pleasure, the corporation must file regular financial reports and its plan of operation must be approved by the department, the corporation's rates are specified by legislation, and all bonds and other indebtedness of the corporation must be approved by a state commissioner). The ruling also found that the state had made a substantial financial commitment to the corporation (by enacting legislation authorizing the corporation to collect the premium tax and to retain the proceeds of the premium tax to augment the corporation's resources).

PLR 200827004 concerned whether an amendment to state law requiring additional assessments from insurers participating in the state insurance fund would alter the previous private letter ruling finding that the insurance fund was an integral part of the state for tax purposes. The ruling found that the state maintained board control over the fund as it had before, and that the amendment had not materially altered the state's financial commitment to the fund, and held that the fund maintained its status as an integral part of the state.

Reliance on AGDC being treated as an integral part of the State is problematic, however, as the IRS has not been consistent over the years in their rulings on whether a corporation formed under a state statute will be treated as an integral part of the state or its subdivisions. Enterprises that would seem to qualify as an integral part of a state or its political subdivisions sometimes receive rulings that they qualify for tax exemption under § 115(1), under which the IRS currently will only issue a favorable ruling based upon a showing of no private benefit.[10]

In sum, AGDC's qualification for tax exemption as an integral part of the State or its political subdivisions cannot be assured without a favorable private letter ruling.

C. The Case for AGDC Qualifying as a Section 115 Entity.

If AGDC were not to qualify, or the Service were not willing to rule that AGDC qualifies, for tax exemption under either implied statutory immunity or as an integral part of the State or its political subdivisions, the next question is whether AGDC qualifies for tax exemption under § 115.

Code § 115(1) provides that the income of AGDC would be excluded from federal taxation if it is derived from the exercise of any essential government function and accrues to the State or any of its political subdivisions.

In private letter rulings, the IRS not only examines the § 115(1) criteria of whether income is derived from the exercise of an essential government function and accrues to the state or its subdivisions but also considers whether private parties would benefit from the entity. The most recent published ruling regarding tax exemption under § 115 is Rev. Rul. 90–74. Revenue Ruling 90–74 held that the income of a nonprofit organization formed by county governments of the state to pool the casualty risks of the member-counties was excluded from income under §115(1), based upon findings that pooling casualty risks instead of purchasing commercial insurance constituted the exercise of an essential government function, that distribution of the assets of the organization upon dissolution to the member-counties satisfied accrual of income for purposes of § 115(1), and that private interests did not, "except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organization."

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[10] E.g., PLR 8934052 (arts commission exempt under § 115, and not as integral part, because a state statute makes it a separate body "corporate and politic").

Essential Government Function

For ruling purposes, the IRS tends to regard anything that makes or saves money for a political subdivision as an essential government function:[11]

> it may be assumed that Congress did not desire in any way to restrict a State's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the State government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Rev. Rul. 77–261. Revenue Ruling 77–261 held that a state investment fund, for the temporary investment of cash balances of the state and its political subdivisions, "constitutes the exercise of an essential governmental function for purposes of section 115(1) of the Code."

A recent private letter ruling with similarities to the Project, PLR 200524015, found that a nonprofit corporation formed by political subdivisions of the state, consisting of natural gas and electric joint action agencies and distribution systems, qualified for exemption under § 115(1). The ruling specifically found that acquiring and financing long-term natural gas supplies, acquiring, constructing, owning, managing, operating and financing natural gas pipelines, liquefied natural gas facilities, storage and related facilities and equipment, and contracting with joint action agencies and public gas or power systems to provide them with natural gas supplies all constituted an essential governmental purpose within the meaning of § 115(1).

Accrual

In order to obtain a private letter ruling under § 115(1), an organization must show that it has satisfied the accrual test by including in its articles of organization a provision limiting distribution upon dissolution of all of AGDC's assets

> to one or more States, political subdivision(s) thereof, the District of Columbia, or to other organizations whose income is excluded from gross income under section 115(1).

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[11] Aprill at 816. Note that there is very little contemporary authority that taxpayers are entitled to rely on, beyond the revenues rulings cited herein, for what constitutes "an essential governmental function" for purposes of §115(1). Case law is less than clear– the United States Supreme Court has concluded that it is essentially impossible to define what an essential governmental function is. The Supreme Court in *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985) concluded that "'[t]here is not, and there cannot be, any unchanging line of demarcation between essential and non-essential governmental functions.'"

Rev. Proc. 2003-12.

AGDC is a corporation specifically authorized by statute, AS 31.25. Alaska Statutes 31.25.010 provides that "[u]pon termination of [AGDC], its rights and property pass to the state," which appears to comply with the ruling requirements of Rev. Proc. 2003–12.

The courts have been less generous in their interpretation of what is required to satisfy the accrual requirement for tax exemption under § 115(1) than the ruling position of Rev. Proc. 2003-12,[12] which only requires disbursement of assets upon dissolution to the state or its political subdivisions to satisfy the accrual requirement. For instance, *City of Bethel v. U.S.*, 594 F.2d 1301 (9th Cir. 1979), *cert. denied*, 444 U.S. 980 (1979)[13] held that the mere accrual of income to a corporation owned by the governmental entity is not considered accrual to the governmental entity. The fact that the assets will revert to the state upon the corporation's dissolution, that the government was the sole owner of the corporation, or even that the state may request payment of profits at any time, did not qualify as direct accrual.

No Private Benefit

The IRS ruling position, that an entity cannot qualify for tax exemption under § 115 if it serves a private interest that is not incidental to the public interest, has no statutory basis. This requirement was apparently first asserted in PLR 8825027, the ruling that denied the Michigan Education Trust exemption under § 115 (a ruling that was effectively reversed by the Sixth Circuit in *Michigan v. United States*). Id. at n. 4.

> To qualify under section 115, it must be established that the income does not serve private interests such as designated individuals, shareholders of organizations, or persons controlled, directly or indirectly, by such private interest. Thus, even if the income serves a public interest, the requirements of section 115 are not satisfied if the income also serves a private interest that is not incidental to the public interest. The basic principle underlying section 115 is that property (including any income thereon) must be devoted to purposes which are considered beneficial to the community in general, rather than particular individuals.

PLR 8825027.

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[12] Rev. Proc. 2003-12 only addresses ruling requirements for a § 501(c)(3) organization that requests a ruling that it is also exempt under § 115(1), but likely reflects the Service's ruling position for an entity affiliated with a state that requests a ruling under § 115(1).

[13] The *City of Bethel* is a Ninth Circuit case, and is binding authority for AGDC.

IRS rulings from the 1990s regarding state-sponsored disaster funds, designed to deal with private insurance companies pulling out of the market for insuring certain forms of risk, illustrate the risk that AGCD's involvement in the Project might be considered by the IRS to benefit private parties. For instance, the Florida and California private letter rulings, respectively PLR 9507037 and PLR 9622019, both found that the respective state disaster funds qualified for tax exemption as integral parts of their respective states, and concluded that, because the fund was an integral part, § 115 did not apply to the fund. Technical Advice Memorandum 9347001 reviewed another state's disaster fund and found that, besides failing to qualify as an integral part of the state or as a political subdivision of the state, the disaster fund also did not qualify for exemption under §115.

In ruling against exemption under §115, TAM 9347001 noted that "the sole purpose of [the fund] is to provide commercial–type insurance for private entrepreneurs," and specifically contrasted the fund with the risk pool at issue in Rev. Rul. 90–74, which pooled the risk exposure of political subdivisions of the state, and where private interests did not benefit more than incidentally. The disaster funds in Florida and California that received favorable rulings in PLR 9507037 and PLR 9622019 likely would not have qualified for exemption under §115 under the same analysis, as those disaster funds primarily benefitted the private individuals seeking insurance coverage that they had not been able to obtain from the private insurance market. See Aprill at 828-830.[14]

AGDC's only owner will be the State or one of the State's political subdivisions. All distributions of AGDC are required by AS 31.25.110 to be distributed to an appropriate fund of the state as determined by the commissioner of revenue in consultation with the commissioner of natural resources. The "appropriate fund of the state" restriction seems intended to bar distributions from AGDC to anything other than a political subdivision or instrumentality of the State.

It will be essential for AGDC to secure a favorable private letter ruling recognizing federal tax exemption under § 115 if AGDC intends to rely on exemption under that provision.

The Concept Document contemplates that AGDC may initially own the entire interest of the organization that would own, develop and operate the Project, and at a later point sell interests in the organization to one or more Producer Parties. Revenue Procedure 2016-03 indicates that the IRS is not willing to issue a private letter ruling on whether such an organization would be exempt from federal income taxation under §115. Section 3.01(21) of Rev. Proc. 2016 – 03 provides that the Service will not issue private

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[14] Also discussing the considerable congressional pressure that was applied by the congressional delegation of California to ensure that California received and retained a favorable private letter ruling.

letter rulings on "[w]hether some, but not all, income of an entity is from the exercise of an essential government function in order to be excluded from gross income under § 115."

D. Instrumentalities.

Alaska Statutes 31.25.010 states that AGDC is "a public corporation and government instrumentality . . ." (emphasis added). For tax purposes, an instrumentality is, by definition, an entity that is not a state or a political subdivision of a state. §§ 3121(b)(7)(F), 3306(c)(7) and 414(d); Rev. Rul. 57–128.

With the exception of certain corporations organized under an act of Congress as instrumentalities of the United States, status as an instrumentality does not indicate whether a corporation such as AGDC is exempt from federal taxation. Code § 501(c)(1) and Rev. Rul. 77–261. Revenue Ruling 77–261 concerned an investment fund established by a state treasurer that was "specifically designated as an instrumentality" of the state. After finding that the investment of funds was the exercise of an essential governmental function and after finding that the fund's income accrued to the state and the participating political subdivisions of the state, Rev. Rul. 77–261 ruled that income of the investment fund was exempt from federal income tax under §115(1). [15]

Designation as an instrumentality has significance for social security tax, federal unemployment tax and eligibility for governmental pension plans. §§ 3121(b)(7)(F), 3306(c)(7) and 414(d). The IRS analyzes whether an organization qualifies as an instrumentality for such purposes under the criteria set forth in Rev. Rul 57-128:

> (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses.

If the IRS concluded that AGDC was an instrumentality, and not a political subdivision or an integral part of the State, it would examine whether AGDC qualified for

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[15] In other words, Rev. Rul. 77 – 261 ruled that the investment fund qualified for tax exemption under § 115(1); that rulng was not based on the fund's status as an instrumentality of the state.

federal tax exemption under either § 115(1) (discussed above) or § 501(c), primarily § 501(c)(3) (discussed below). Aprill at 821.

If AGDC is considered an instrumentality of the State, it will be essential for AGDC to secure a favorable private letter ruling recognizing federal tax exemption under § 115 if AGDC does not qualify for exemption as a political subdivision of the State or as an integral part of the State.

E. § 501(c)(3) Organizations.

AGDC, as a " public corporation and instrumentality" of the State could qualify for exemption under §501(c)(3) if it were a "clear counterpart" of a charitable, educational, religious or like organization. Rev. Rul. 60–384; see also Rev. Rul. 55–319. There is at least an issue whether the IRS would consider AGDC, investing in a liquefied natural gas Project, to be a "clear counterpart" of a charitable organization.

AGDC's police powers, discussed above, would seem to keep AGDC from qualifying for exemption under § 501(c)(3). Revenue Ruling 60-384 observed that

> where a wholly-owned state . . . instrumentality exercises enforcement or regulatory powers in the public interest such as health, welfare, or safety, it would not be a clear counterpart of an organization described in section 501(c)(3) of the Code even though separately organized since it has purposes or powers which are beyond those described in section 501(c)(3).

In Rev. Rul. 74–14, a public housing authority was denied exemption under § 501(c)(3), even though its purpose was to provide safe housing accommodations for low income families, because the state statute incorporating the authority gave it the power to conduct examinations and investigations for the purpose of collecting information and making it available to appropriate agencies for use in furthering and enforcing local ordinances regarding planning, building, and zoning matters. Revenue Ruling 74–14 concluded this power to conduct examinations and investigations was a regulatory power that was inconsistent with exemption under § 501(c)(3).

For reasons such as those set forth above, § 501(c)(3) seems the least likely ground for AGDC to qualify for federal tax exemption.

II. Tax Issues Raised by the Organization That the Project Documents Contemplate Would Own, Develop and Operate the Project.

A. Initial Considerations.

The recitals of the Concept Document state that AGDC would organize a company that "will own, commercialize, finance, design, build and operate the [Project]." The

Concept Document does not state what kind of company AGDC would organize to own, commercialize, finance, design, build and operate the Project.

Alaska Statutes 31.25.120 empowers AGDC to form subsidiary corporations for the purpose of developing, constructing, operating, and financing in-state natural gas pipeline projects or other transportation mechanisms; for the purpose of aiding in the development, construction, operation, and financing of in-state natural gas pipeline projects; or for the purpose of acquiring natural gas from the North Slope, and natural gas from other regions of the state, including the state's outer continental shelf, and making that natural gas available to markets in the state, including the delivery of natural gas, including propane and other hydrocarbons associated with natural gas other than oil, to coastal communities in the state, or for export.[16]

Oil and gas development ventures in the United States are typically organized as tax partnerships or co-tenancies in order to provide pass-through treatment to the owners of all tax attributes of the venture–including income, gain, loss, deductions and credits.

However, AS 31.25.120 only authorizes AGDC to organize a subsidiary entity that is a corporation for purposes of the Project. Alaska Statutes 31.25.080(a)(1) grants AGDC the authority to determine the form of ownership and the operating structure of an in-state natural gas pipeline developed by AGDC, but as to an Alaska liquefied natural gas project, AS 31.25.080(a)(1) only expressly authorizes AGDC to "enter into agreements with other persons for joint ownership, joint operation or both."

AGDC may form a subsidiary corporation to own its interest in the Project, at least for liability protection reasons afforded by the corporate form of the subsidiary, but possibly also to separate the Project activities of the subsidiary from the other activities of AGDC.

Regarding the tax status of a subsidiary corporation formed by AGDC to own its interest in the Project, Treas. Reg. § 301.7701-1(a)(3) provides that if AGDC wholly owns a corporation, the subsidiary's corporate status should not prevent the subsidiary from being treated as an integral part of the state for tax purposes:

> an organization wholly owned by a State is not recognized as a separate entity for federal tax purposes if it is an integral part of the State.

If AGDC's subsidiary corporation owned the entire interest in the Project for the life of the Project, and assuming that AGDC is determined to be an integral part of the state, all tax attributes of the Project would flow through to AGDC. All income and gain from the

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[16] Alaska Statutues 31.25.120 does not expressly authorize AGDC to organize a subsidiary corporation that would own an interest in a gas liquefaction plant and/or marine terminal, powers which may be reserved to AGDC itself.

Project may also be exempt from federal taxation, assuming that the IRS acknowledges that AGDC's wholly-owned subsidiary is indeed an integral part of the state.[17]

B. Tax Considerations of the Operating Entity as Contemplated by the Project Documents.

The Concept Document contemplates that Producer Parties would be invited to become owners of the organization owning, developing and operating the Project and specifically contemplates that one or more Producer Parties would provide development funding for the Development Phase of the Project. In order for the organization that owns, commercializes, finances, designs, builds and operates the Project to be a viable investment for one or more Producer Parties, the organization likely would need to be structured as a pass-through entity, either a tax partnership (such as a limited liability company) or a tenancy in common. Unless a pass-through entity owns, develops and operates the Project, the tax attributes of the Project would not flow through to the respective tax returns of the Continuing Parties.

If the organization that owns, develops and operates the Project were instead an AS 31.25.120 corporate subsidiary of AGDC, and one in which AGDC only owns a partial interest, the corporate subsidiary would be treated as a separate corporate entity. Although income would flow through, when dividends are declared, to the owners of the corporate subsidiary that owns, develops, and operates the Project, other tax attributes, such as losses, deductions and tax credits would only be available to the organization itself and would not flow through to owners of the organization. Treas. Reg. § 301.7701–1. This may not be a viable planning option for the Producer Parties, who typically would expect that their respective shares of all tax attributes from the organization owning, developing and operating the Project would flow through to their respective income tax returns.

Assuming that the Operating Entity Were a Pass-Through Entity

If the organization that owns, develops and operates the Project were in part owned, directly or indirectly, by AGDC, and in part owned by one or more of the Producer Parties, the question is what the tax status of that organization would be.

Whether the Operating Entity Could Be a Political Subdivision

AGDC might argue that the organization that owns, develops and operates the Project, in part owned, directly or indirectly, by AGDC and in part owned by one or more Producer Parties, would be exempt from federal income taxation as a political subdivision

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[17] The state, AGDC, and wholly-owned subsidiaries of AGDC could seek substantially identical private letter rulings on this issue, as part of the same ruling request.

of the State of Alaska, based on AGDC's ability to exercise its sovereign powers of eminent domain and its police powers to issue regulations governing the organization, including regulating land used by the organization. Considering the position taken by the Service in promulgating Prop. Treas. Reg. § 1.103-1(c), defining a subdivision for purposes of § 103, it is doubtful that the Service would issue a private letter ruling finding such an organization to be a political subdivision of the State of Alaska.

Namely, Prop. Treas. Reg. § 1.103-1(c) would provide that an entity can only be considered a political subdivision, at least for purposes of issuing tax-exempt bonds under § 103, if the entity, in addition to having one or more sovereign powers: (a) has a governmental purpose and (b) is governmentally controlled.

In order to show that the entity serves a governmental purpose, Prop. Treas. Reg. § 1.103-1(c) requires evidence that the entity : (1) carries out the public purposes set forth in the entity's enabling legislation, (2) operates in a manner that provides a significant public benefit and (3) provides no more than an incidental private benefit.

The organization that owns, develops and operates the Project may be able to show that it carries out the stated public purposes of AGDC, namely that the entity shall exercise its powers for the benefit of the people of the State of Alaska, for their well-being and prosperity, and for the improvement of their social and economic conditions. The organization may also be able to show that it operates in a manner that provides a significant public benefit. However, it is hard to see how the organization that owns, develops and operates the Project would not provide more than an incidental private benefit, considering that the Concept Document contemplates that the organization will have one or more Producer Parties as owners.

Further, Prop. Treas. Reg. § 1.103-1(c) also would require that a state or local governmental unit exercise control over the organization owning, developing and operating the Project. Control is defined under Prop. Treas. Reg. § 1.103-1(c)(4)(i) as meaning an ongoing right or power to direct significant actions of the entity, including the right or power to elect a majority of the governing body of the entity in periodic elections of reasonable frequency.

The Concept Document indicates that, after one or more Producer Parties have become owners of the organization owning, developing and operating the Project, that AGDC would no longer control the organization. First, the annual Work Program and Budget ("WP & B") must be unanimously approved by the Continuing Parties each year. Sect. 4.2(b). This means that if even one Producer Party were an owner of the organization, it would have a veto over WP & B.

In other respects the Concept Document provides no assurance that AGDC would continue to control the organization owning, developing and operating the Project after one or more Producer Parties becomes a member of the organization. For instance Sect. 4.2(c) indicates that a Continuing Party, including a Producer Party, which pays its shares of the year's WP & B is entitled to participate in the organization's Management Committee. Further, the Management Committee consists of a representative from each of the Continuing Parties. This means that a Producer Party with a relatively small share of the year's WP & B would be entitled to have the same representation on the Management Committee as any other Continuing Party, including AGDC or its AS 31.25.120 corporate subsidiary, or even the largest Continuing Party. If the Management Committee consisted of AGDC and just two Producer Parties, AGDC would not control the Management Committee unless at least one of the Producer Parties votes in concert with AGDC.

Finally, Sect. 5.4 provides that the organization that owns, develops and operates the Project "shall have charge of, and shall conduct, all Operations" . . .. No provision is made in the Sect. 5.4 to ensure that AGDC has control over the operations of the organization.

Whether the Operating Entity Could Be an Integral Part of the State

The Tax Court's analysis in *Uniband* indicates that the organization that owns, develops and operates the Project, in part owned, directly or indirectly, by AGDC and in part owned by one or more Producer Parties, would not qualify as an integral part of the state. As in *Uniband*, the organization that would own, develop and operate the Project likely would be organized as a state law business entity or tenancy in common, the Project Documents do not guarantee that the state will have control over the organization, and the organization will have significant financial autonomy from the state. Under the Tax Court's analysis in *Uniband*, these characteristics would result in the organization that owns, develops and operates a Project not being regarded an integral part of the state. If the *Uniband* analysis applied to the organization, the organization would not be able to claim exemption from federal income taxation based on being an integral part of the state.

Private letter rulings in recent years addressing whether a corporation formed by a state, like AGDC, qualifies for federal tax exemption as an integral part of the state generally look to whether (a) there is sufficient state control over the entity and (b) whether the state has made a financial commitment to fund the entity. E.g., *Non Profit Ins. Program v. United States* (E.D. Wash. 2016), PLR 200524015. While the Concept Document appears to commit the State to make some financial commitment to fund the entity, it may be difficult for AGDC or the organization to convince the IRS in a private letter ruling request that the state will have sufficient control over the organization, in part owned,

directly or indirectly, by AGDC and in part owned by one or more Producer Parties, that owns, develops and operates the Project.

Whether the Operating Entity Could Be Exempt under §115

Private Letter Ruling 201142016, discussed above, illustrates that, if the organization that owns, develops and operates the Project is in part owned by AGDC and in part owned by one or more Producer Parties, that the organization would not be an integral part of the State, and would likely also fail to qualify for tax exemption under Code § 115,[18] and thus may be subject to Federal income taxation, at least as to the participating Producer Parties.

In PLR 201142016, the Service required evidence, as a condition of ruling that income of the public utility is exempt from federal income taxation under § 115, that there would be no incidental private benefit. It may be difficult to prove that the Producer Parties, which the Concept Document contemplates will own an interest in the organization that owns, develops and operates the Project, would receive no benefit from their participation in the Project.

Private Letter Ruling 201142016 cited Rev. Rul. 90-74 in support of its ruling. Revenue Ruling 90–74 ruled that when political subdivisions of a state create, fund, and operate an organization to pool the casualty risks of the participating political subdivisions, the organization was exempt from income tax under § 115(1), finding that private interests neither materially participated in the organization nor benefitted more than incidentally from the organization. In the case of the organization described in the Concept Document that would own, develop and operate the Project, private interests would materially participate in the organization and likely would more than incidentally benefit from the organization.

Moreover, Rev. Proc. 2016-03, Section 3.01(21) provides that the Service will not issue private letter rulings on "[w]hether some, but not all, income of an entity is from the exercise of an essential government function in order to be excluded from gross income under § 115." This suggests that the neither the state nor AGDC[19] could obtain a private letter ruling finding that AGDC's income from a partial interest in an organization owning, developing and operating the Project would be exempt from federal income tax under § 115.

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[18] And would certainly fail to qualify for tax exemption under Code § 501(c)(3).

[19] And also not any subsidiary of AGDC.

III. Conclusion.

For the reasons outlined above, unless AGDC and/or a wholly-owned subsidiary owns, for the lifetime of the Project, the entire interest in the organization that owns, develops and operates the Project, then the organization that owns, develops and operates the Project will likely be subject to federal income taxation.

That being said, if AGDC and/or its wholly-owned subsidiaries can qualify for federal income tax exemption as a political subdivision of the state, as an integral part of the State or under § 115,[20] its interest in a taxable organization that owns, develops and operates the Project should be exempt from Federal income taxation.

If AGDC and/or its wholly-owned subsidiaries own all of a discrete portion of the Project, for the lifetime of the Project, and if AGDC and any of its wholly-owned subsidiaries qualify for federal income tax exemption as a political subdivision of the state, as an integral part of the State or under § 115,[21] AGDC's interest in the discrete portion of the Project should be exempt from Federal income taxation. The discrete portions of the Project owned by one or more Producer Parties would likely be subject to federal income taxation.

Because of the complexity of the tax issues raised by the Project Documents, the State, AGDC, and any applicable wholly-owned subsidiary of AGDC are advised to seek a private letter ruling on their participation in the Project once they have finalized their contractual commitments to the Project.

Notice Regarding Tax Advice

In a contract of even date, the Committee has requested that Manley & Brautigam P.C. provide written advice about the following Federal income tax issues raised by the Project Documents on or before August 24, 2016. Due to the specified time constraint, this letter is a discussion of issues certain federal income tax issues raised by the Project Documents, but cannot be relied on as a definitive tax analysis of all the federal income tax consequences raised by the Project Documents.

We hope that this letter helps explain some of the federal tax exemption issues raised by the Project and the related pending legislation. We would be happy to expand

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[20] The Service's non-ruling position set forth in Rev. Proc. 2016-03, Section 3.01(21) indicates that the Service would decline to issue a tax exemption ruling in this context under § 115.

[21] It is conceivable, depending on how broadly the Service construes its non-ruling position set forth in Rev. Proc. 2016-03, Section 3.01(21), the Service might decline to issue a tax exemption ruling under § 115 in this context as well.

upon our analysis should the Committee or the Legislature so desire or to address any particular questions that the Committee or the Legislature may have.

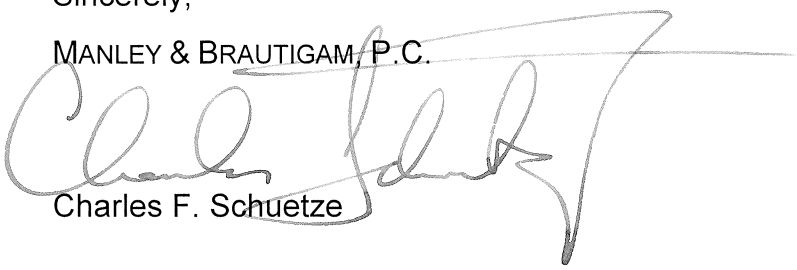
This letter has been prepared solely for use by the state, the Legislative Budget & Audit Committee, and the Alaska state legislature.

The advice in this letter is not binding on the Internal Revenue Service, any court, or any other person or entity. The Internal Revenue Code has been subject to substantial and frequent revisions in recent years. We cannot assure that forthcoming IRS interpretations, administrative pronouncements, or court decisions will not adversely affect the tax advice given in this letter.

Realization of federal tax exemption is subject to the risk that the Internal Revenue Service may challenge tax treatment and that a court may sustain that challenge. Because taxpayers carry part of the burden of proof required to support the tax treatment of a transaction, the advice expressed as to the likelihood of realization of federal tax exemption assumes that you will undertake the effort and expense to request an appropriate private letter ruling and present fully the State's case in support of any matter that the Service challenges.

Sincerely,

MANLEY & BRAUTIGAM, P.C.



Charles F. Schuetze