INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

July 7, 2001

Number: **200147012**
Release Date: 11/23/2001
Index (UIL) No.: 162.00-00
263.00-00
CASE MIS No.: TAM-113165-00/CC:ITA:B1

Director, Field Operations
Large & Mid-Size Business (LMSB)
Natural Resources, Houston

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer	=
City	=
Region	=
$a	=
b	=
c	=
d	=
e	=
f	=
g	=
h	=
i	=
j	=
k	=
l	=
m	=
n	=
$o	=
$p	=
$q	=
Date 1	=
Date 2	=
Date 3	=

Date 4 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Firm =

ISSUE:

Whether Taxpayer may deduct the value of land previously received by it tax-free under the Alaska Native Claims Settlement Act (ANCSA) and conveyed to City as required by § 14(c)(3) of ANCSA.

CONCLUSION:

Taxpayer may deduct the value of land previously received by it tax-free under ANCSA and conveyed to City as required by § 14(c)(3) of ANCSA.[1]

BACKGROUND OF ANCSA:

ANCSA was enacted in 1971 to settle the aboriginal land claims of Alaska Natives.[2] According to principles of federal Indian law, aboriginal, or "Indian," title is an exclusive right of possession and occupancy held by the aboriginal inhabitants of America in lands in which fee title is possessed by the United States, as sovereign.

ANCSA was preceded by more than 100 years of uncertainty about the legal status of the Alaska Natives. This uncertainty would have clouded title to Alaska property for decades. ANCSA extinguished the aboriginal title of the Alaska Natives and, in exchange, and in settlement therefor, granted to the Alaska Natives the right to select and to receive fee title from the United States to some 44 million acres of public federal land in Alaska and to receive payment from the United States of $962.5 million.

To implement the settlement, ANCSA divided Alaska into 12 geographic regions. Natives residing in each region were authorized to organize a for-profit business

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[1] Taxpayer's valuation of the portion of land conveyed to City is not at issue in this request for technical advice.

[2] Certain sections of ANCSA have been amended by subsequent legislation, including the Alaska National Interest Lands Conservation Act (ANILCA), enacted on December 2, 1980.

corporation under the laws of the state of Alaska. In addition, Natives residing in some 200 Native Villages, and several urban towns, were authorized to organize either an Alaska for-profit or nonprofit corporation.

The cash portion of the settlement, $962.5 million, was distributed to the Regional Corporations over a period of 12 years. Also, each Regional, Village, and Urban Corporation was granted the right to select and receive conveyance to a specified portion of the 44 million acre land settlement.

Upon enactment, and subject to valid existing rights, Section 11 of ANCSA withdrew certain public lands in Alaska from all forms of appropriation under the public land laws, including the mining and mineral leasing laws, and from selection under the Alaska Statehood Act. In general, the lands withdrawn and thus reserved for selection by the Native Corporations consisted of: (a) the lands in each township[3] that enclosed all or any part of a Native village identified pursuant to ANCSA (the "core" township), plus (b) the lands in each township that were contiguous to or cornered on the core township, plus (c) the lands in each township that were contiguous to or cornered on a township described in (b).[4]

Under Section 12(a)(1) of ANCSA, the Village Corporations were given three years from the date of enactment of ANCSA to select the particular lands to which they were entitled under the Act. Section 12(a)(1) states that a Village Corporation must select "all of the township or townships in which any part of the village is located," plus such additional area from the lands withdrawn pursuant to Section 11 that would make the total selection equal to the acreage to which the corporation was entitled. Although Section 12(a)(1) appears to mandate selection by a Village Corporation of all lands contained in the core township in which the village is located, this requirement is subject to a number of qualifications. For example, land that was not in federal ownership was not available for selection. In addition, under Section 22(l) of ANCSA, Native Corporations were prohibited from selecting lands within two miles from the boundaries of any home rule or first class city.

By itself, selection of land by a Village Corporation pursuant to ANCSA does not confer any ownership rights on the corporation. Prior to actual conveyance, legal title to selected land remains in the United States. Ownership of selected lands passes to a Native Corporation as a result of conveyance pursuant to Section 14 of ANCSA. Under Sections 14(a) and 14(b), as supplemented by Section 22(j)(1), lands selected by a Village Corporation are conveyed by the United States either by patent or "interim

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[3] By law, federal lands are divided into "townships," which are square areas of land measuring six miles by six miles (36 square miles or 23,040 acres).

[4] Section 11(a)(1) of ANCSA.

conveyance." Lands that have been surveyed are conveyed by patent; lands that have not yet been surveyed at the time of conveyance may be conveyed by the issuance of an interim conveyance, the force and legal effect of which is to convey and vest in the Native Corporation exactly the same right, title, and interest in and to the lands as a patent. Upon survey of the lands covered by an interim conveyance, a patent is issued to the recipient.[5]

Section 14(c) of ANCSA (as amended by ANILCA) imposes certain requirements on Native Corporations with respect to their lands. Specifically, Section 14(c) of ANCSA states:

> Each patent issued pursuant to subsections (a) and (b) shall be subject to the requirements of this subsection. Upon receipt of a patent or patents:
>
> (1) the Village Corporation shall first convey to any Native or non-Native occupant, without consideration, title to the surface estate in the tract occupied as of December 18, 1971 . . . as a primary place of residence, or as a primary place of business, or as a subsistence campsite, or as headquarters for reindeer husbandry;
>
> (2) the Village Corporation shall then convey to the occupant, either without consideration or upon payment of an amount not in excess of fair market value, determined as of the date of initial occupancy and without regard to any improvements thereon, title to the surface estate in any tract occupied as of December 18, 1971, by a nonprofit organization;
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> (3) the Village Corporation shall then convey to any Municipal Corporation in the Native village or to the State in trust for any Municipal Corporation established in the Native village in the future, title to the remaining surface estate of the improved land on which the Native village is located and as much additional land as is necessary for community expansion, and appropriate rights-of-way for public use, and other foreseeable community needs: *Provided,* That the amount of lands to be transferred to the Municipal Corporation or in trust shall be no less than 1,280 acres unless the Village Corporation and the Municipal Corporation or the State in trust can agree in writing on an amount which is less than one

[5] At the time ANCSA was enacted, most of the some 375 million acres of land in Alaska were still unsurveyed. Section 13 of ANCSA accordingly provides for surveying of lands selected or otherwise designated for conveyance by ANCSA to Village Corporations.

> thousand two hundred and eighty acres: *Provided further,* That any net revenues derived from the sale of surface resources harvested shall be paid to the Village Corporation by the Municipal Corporation of the State in trust: *Provided, however,* That the word "sale," as used in the preceding sentence, shall not include the utilization of surface resources for governmental purposes by the Municipal Corporation or the State in trust, nor shall it include the issuance of free use permits or other authorization for such purposes;
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> (4) the Village Corporation shall convey to the Federal Government, State or to the appropriate Municipal Corporation, title to the surface estate for existing airport sites, airway beacons, and other navigation aids as such existed on December 18, 1971, together with such additional acreage and/or easements as are necessary to provide related services and to insure safe approaches to airport runways as such airport sites, runways, and other facilities (that) existed as of December 18, 1971. . . .

Each of these paragraphs in Section 14(c) of ANCSA impose on a Village Corporation an obligation with respect to the lands received under the Act. The Alaska Native Foundation, the state of Alaska, and the Bureau of Land Management have all characterized Section 14(c) as creating a "cloud" on the title of all ANCSA lands owned by a Village Corporation.

Section 21 of ANCSA (as amended by ANILCA) provides special tax provisions to ensure that the receipt of certain revenues, stock, and land by the Native Corporations were tax-free. Specifically, Section 21 provides:

> (a) Revenues originating from the Alaska Native Fund shall not be subject to any form of Federal, State, or local taxation at the time of receipt by a Regional Corporation, Village Corporation, or individual Native through dividend distributions or in any other manner. . . .
>
> (b) The receipt of shares of stock in the Regional or Village Corporations by or on behalf of any Native shall not be subject to any form of Federal, State or local taxation.
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> (c) The receipt of land or any interest therein pursuant to this Act or of cash in order to equalize the values of properties exchanged pursuant to subsection 22(f) shall not be subject to any form of Federal, State, or local taxation. The basis for determining gain or loss from the sale or other disposition of such land or interest in land for purposes of any Federal, State, or local tax imposed on or measured by income shall be the fair

> value of such land or interest in land at the time of receipt, adjusted as provided in section 1016 of the Internal Revenue Code of 1954, as amended. . . . For purposes of this subsection, the time of receipt of land or any interest therein shall be the time of the conveyance by the Secretary of such land or interest (whether by interim conveyance or patent).

Section 21(h) of ANCSA (as added by Public Law 95-178 on November 15, 1977) also provides special tax provisions regarding the selection and conveyance of land to the Native Corporations. Section 21(h) states:

> (1) Notwithstanding any other provision of law, each Native Corporation established pursuant to this Act shall be deemed to have become engaged in carrying on a trade or business as of the date it was incorporated for purposes of any form of Federal, State, or local taxation.
>
> (2) All expenses heretofore or hereafter paid or incurred by a Native Corporation established pursuant to this Act in connection with the selection or conveyance of lands pursuant to this Act, or in assisting another Native Corporation within or for the same region in the selection or conveyance of lands under this Act, shall be deemed to be or to have been ordinary and necessary expenses of such Corporation, paid or incurred in carrying on a trade or business for purposes of any form of Federal, State, or local taxation.

Thus, Native Corporations are deemed to be carrying on a trade or business and their expenses to select or convey lands under ANSCA are deemed to be deductible for purposes of any form of federal taxation.

FACTS:

Taxpayer is a Village Corporation located in City, Alaska, and is within the geographic region encompassed by Region Native Corporation, a Native Regional Corporation. Pursuant to ANCSA, Taxpayer was entitled to receive $a and rights to the surface estate to some b acres of land. ANCSA permitted Taxpayer to make its Section 12(a) selections from c townships around City. However, the federal government owned very little land within the boundaries of City. In addition, City is a first class city and, as a result of ANCSA Section 22(l), there were doubts about Taxpayer's entitlement to select lands in City or within two miles of its boundaries.

In accordance with Section 12(a) of ANCSA, Taxpayer was obligated to exercise its selection rights within three years of December 18, 1971, the date of ANCSA's enactment. However, because of the uncertainties about which federal lands were available for selection (in addition to the two-mile boundary question, most of Alaska

was unsurveyed, and there were many competing claims to federal lands that had yet to be resolved), Taxpayer, like most Native Corporations, overselected, indicating its priority among selections. Nearly all of the land Taxpayer selected was located well outside the existing boundaries of City and did not abut any existing City-owned land outside the city limits. Through Year 1, Taxpayer has received Section 12(a) conveyance under d patents to the surface estate to e acres and f interim conveyance documents to the surface estate to g acres. Taxpayer is still awaiting conveyance of approximately h acres of Section 12(a) land selections.

As a Village Corporation, Taxpayer's lands were burdened by Section 14(c)(3) of ANCSA, which obligates each Native Corporation to convey to the municipality the "improved land on which the Native village is located" and additional land as necessary for "community expansion" and "appropriate rights-of-way for public use" and "other foreseeable community needs." Discussions between Taxpayer and City regarding 14(c)(3) land conveyances began as early as Year 2, before Taxpayer had received conveyance to any of its lands. From the start, it was clear that the discussions would involve detailed and protracted negotiations, not only about the identification and size of parcels, but also about the type of interest – fee ownership vs. easement – that would be conveyed. It was not until some 15 years later, in Year 3, that a final agreement was reached for the conveyance to City of fee title to i separate parcels aggregating j acres and k separate easements encompassing l acres. The agreement also provided for the conveyance to Taxpayer of m City-owned properties encompassing n acres. The agreement was committed to writing and was signed on behalf of Taxpayer and City on Date 1.

On its corporate income tax returns for the tax years ended Date 2, Date 3, and Date 4, Taxpayer claimed deductions identified as "14(c) Conveyance" of $o, $p, and $q, respectively. The amounts of these deductions were based on the appraised values arrived at by Firm. The appraisals of real property transferred (or to be transferred) to City were done in Year 4 but were based on the values as of the date of conveyance (via interim conveyance or patent) to Taxpayer by the U.S. Government during the period from Year 5 to Year 6.

LAW AND ANALYSIS:

Taxpayer argues that the fair market value of property it conveyed to City in satisfaction of its Section 14(c)(3) obligation is an ordinary and necessary business expense under Section 21(h) of ANCSA and under § 162. Taxpayer further argues that the Section 14(c)(3) conveyance is not a capital expenditure under § 263.

Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 161 provides that in computing taxable income, a deduction is allowed for the items specified in part VI (which includes § 162), subject to the exceptions

provided in part IX (which includes §§ 263 and 265). See also § 261.

Section 263(a) provides that no deduction is allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. Section 1.263(a)-2(c) of the Income Tax Regulations provides that the cost of defending or perfecting title to property is a capital expenditure

Taxpayer contends that Section 21(h) of ANCSA precludes the Service from concluding that the Section 14(c)(3) conveyances were capital expenditures under § 1.263(a)-2(c).[6] Section 21(h) provides that all expenses paid or incurred by a Native Corporation established pursuant to ANCSA in connection with the selection or conveyance of lands pursuant to ANCSA are deemed to be or to have been ordinary and necessary expenses of the Corporation, paid or incurred in carrying on a trade or business for purposes of any form of Federal, State, or local taxation. The issue raised by this provision of ANCSA is whether the fair value of lands conveyed by Taxpayer to City in accordance with Section 14(c)(3) are expenses paid or incurred in connection with the selection or conveyance of lands pursuant to ANCSA.

In amending ANCSA to add § 21(h), the House Conference Report stated the purpose of the amendment as follows:

> The IRS has held that (1) the value of surveys of the land made by oil companies to assist the Corporations in making their selections is income to the Corporations; (2) land selection costs incurred by the Corporations are not deductible but must be added to the basis for the land; and (3) other expenses of the Corporation are nondeductible "start-up" costs because the Corporations have not yet begun business. Because many Native shareholders are related to one another, some Corporations may meet the definition of personal holding companies.

H.R. Conf. Rep. No. 1800, 95th Cong., 2d Sess., 282 (1978). The amendment provides that Native Corporations (1) do not include in income the value of outside surveys; (2) may deduct land selection costs; (3) are deemed to have begun business; and 4) are not personal holding companies. H.R. Conf. Rep. No. 1800, 95th Cong., 2d Sess. 282 (1978). Thus, it is clear that Congress was concerned with the Service requiring

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[6] Section 14(c) of ANCSA imposes on a Village Corporation an obligation with respect to the lands received under the Act. The Alaska Native Foundation, the state of Alaska, and the Bureau of Land Management have all characterized Section 14(c) as creating a "cloud" on the title of all ANCSA lands owned by a Village Corporation. The costs of removing a cloud on the title of property generally must be capitalized. See, e.g., Lucas v. Commissioner, 388 F.2d 472 (1st Cir. 1967); Brand v. Commissioner, 209 F.2d 255 (6th Cir. 1953); Farmer v. Commissioner, 126 F.2d 542 (10th Cir. 1942); Wacker v. Commissioner, T.C. Memo 1980-324.

capitalization of land selection and conveyance costs and intended that the amendment allow a deduction for those costs.

The statute, however, does not define "in connection with the selection or conveyance of lands pursuant to ANCSA." The Service previously read this provision of ANCSA narrowly. In Old Harbor Native Corporation v. Commissioner, 104 T.C. 191 (1995), one issue was whether the taxpayer, an Alaska native village corporation organized under ANCSA, could deduct as an ordinary and necessary business expense an amount paid to lobby the Congress to pass legislation allowing it to exchange certain lands with the United States Government under ANCSA. The land exchange at issue was governed by Section 22(f) of ANCSA, which provides:

> The Secretary [of Interior]. . . [is] authorized to exchange lands or interests therein, including Native selection rights, with the corporations organized by Native groups, Village Corporations, Regional Corporations, and the corporations organized by Natives, . . . and other municipalities and corporations or individuals, the State, . . . or any Federal agency for the purpose of effecting land consolidations or to facilitate the management or development of the land, or for other public purposes. . . .

The Service argued that Section 21(h)(2) of ANCSA (43 U.S.C. § 1620(h)(2)) was intended to apply only to the Native Corporations' initial selection and conveyance of lands under ANCSA, and not to subsequent land exchanges under ANCSA. The court held otherwise, stating:

> We do not read 43 U.S.C. section 1620(h)(2) [Section 21(h)(2) of ANCSA] as narrowly as respondent. To the contrary, we read ANCSA broadly and in the light most favorable to Alaskan natives, the intended beneficiaries of ANCSA. We also view and read ANCSA as a whole, rather than viewing and reading each section of ANCSA separately and in isolation. The phrase "pursuant to this chapter," which follows the phrase "in connection with the selection or conveyance of lands," refers to any section within ANCSA. This statutory language is clear and unambiguous. Therefore, the beginning and end of our inquiry is the statutory text, and we apply the plain and common meaning of the text as written by the Congress. It is well settled that the text is conclusive, absent a clear legislative intent to the contrary. We have found no *clear* legislative intent to the contrary.

(Citations omitted). Old Harbor Native Corp., 104 T.C. at 204-205. Applying this rationale to the facts at issue, the court concluded that the lobbying expenses were incurred in connection with a conveyance of land within the meaning of Section 21(h)(2) of ANCSA. Thus, the expenses were deductible under that section.

Under the rationale of the court in Old Harbor Native Corp., the Section 14(c)(3) conveyance was made "in connection with the selection or conveyance of lands" under

ANCSA. Section 14(c)(3) requires a conveyance of land under the Act. This conveyance is encompassed in the clear and unambiguous statutory language of Section 21(h)(2). There is no clear legislative intent to the contrary. Thus, considering the unique facts and circumstances surrounding the enactment of Section 21(h)(2), and reading that section in the light most favorable to the Alaska Natives, we find that Section 21(h)(2) deems the fair market value of the lands conveyed in accordance with Section 14(c)(3) to be an ordinary and necessary business expense. Therefore, the fair market value of the lands conveyed by Taxpayer is deductible under § 162 for federal income tax purposes.

A copy of this technical advice memorandum is to be given to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.