

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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DO: TY:

Taxpayer:

Taxpayer's EIN:

Taxpayer's address:

A =
Trust =
Trust Agreement =

Tribe =
Ordinance =

Section A =
Section B =
State A =

Dear :

This letter responds to Taxpayer's request for a private letter ruling, dated December 16, 1998, regarding the federal income tax consequences of the trusts established by the Taxpayer under §§ 61, 671, 675, and 677 of the Internal Revenue Code.

ISSUES

1. Are the minor and incompetent members of the Tribe in constructive receipt or do they derive an economic benefit when the amounts are contributed to Trust or as income is earned by the Trust?
2. Is Taxpayer, having established Trust for the benefit of its minor and otherwise incompetent members, the grantor of Trust?
3. Is Taxpayer the owner of Trust under § 675(4)(C)?

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4. If Taxpayer is not subject to federal income taxes, are there tax consequences to Taxpayer for funds paid into Trust, or income earned by Trust?

CONCLUSIONS

Based on the information submitted and representations made, we conclude as follows:

1. The minor and incompetent members of the Tribe are not in constructive receipt and do not derive an economic benefit when the amounts are contributed to Trust or as income is earned by the Trust.

2. The Tribe is the grantor of Trust.

3. Provided that the circumstances surrounding Trust's administration indicate that the power of administration held by the Tribe over Trust (i.e. the power to substitute assets for assets of equivalent value) is exercisable by the Tribe in a nonfiduciary capacity without the approval or consent of a person in a fiduciary capacity and provided that this power applies to all property of Trust either initially contributed or additional property contributed under section 1.3 of the Trust Agreement, the Tribe will be treated as the owner of Trust under § 675.

4. Assuming that the Tribe is treated as the owner of Trust under § 675, the Tribe, which is not subject to federal income tax, shall not be subject to federal income tax on the income of Trust nor will there be any tax consequences to the Tribe upon funding of Trust. Rev. Rul. 94-16, 1994-1 C.B. 19; Rev. Rul. 67-284, 1967-2 C.B. 55.

FACTS

Taxpayer (or the "Tribe") is a federally recognized Indian tribe organized under the Indian Reorganization Act of 1934, 25 U.S.C. § 461 *et seq.* Taxpayer uses an accrual method of accounting for federal income tax purposes and computes income on the basis of a fiscal year starting October 1 and ending September 30.

Taxpayer conducts gaming operations on tribal lands pursuant to its self-determination powers and pursuant to federal common law and the Indian Gaming Regulatory Act, 25 U.S.C. §§ 2701 *et seq.* ("IGRA"), enacted by Congress in 1988. IGRA was enacted to provide a statutory basis for the operation of gaming by Indian tribes enabling tribes to achieve economic development, tribal self-sufficiency, and a strong government.

Section 2710(b)(3) of IGRA provides that net revenues from any class II gaming activities conducted or licensed by any Indian tribe may be used to make per capita

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payments to members of the Indian tribe only if (A) the Indian tribe has prepared a plan to allocate revenues to uses authorized by section 2710(b)(2)(B); (B) the plan is approved by the Secretary of the Interior as adequate, particularly with respect to uses described in section 2710(b)(2)(B)(i) or (iii); (C) the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved and the per capita payments are disbursed to the parents or legal guardian of such minors or legal incompetents in such amounts as may be necessary for the health, education, or welfare, of the minor or other legally incompetent person under a plan approved by the Secretary of the Interior and the governing body of the Indian tribe; and (D) the per capita payments are subject to Federal taxation and the tribes notify members of such tax liability when payments are made.

Pursuant to section 2710 of IGRA, the Tribe has elected to distribute a portion of its gaming revenue in the form of a per capita payment to its membership by adopting the revenue allocation plan codified in the Ordinance. Section A of the Ordinance provides that per capita payments will only be distributed to enrolled members of the Tribe. The revenue allocation plan was approved by the Secretary of the Interior.

Section B of the Ordinance requires that the revenue designated to pay per capita payments of minor or incompetent members be placed in an irrevocable trust (Trust) administered by an independent institutional trustee. Section B of the Ordinance provides that the Tribe tribal council has the inherent authority to place into trust the per capita payments, or any portion or percentage thereof, of any minor or individual who is declared incompetent by a court of competent jurisdiction. The revenue allocation plan with respect to minors and incompetent members was approved by the Secretary of the Interior.

The Tribe is named as the settlor of Trust, and A as the trustee. The minor or incompetent members of the Tribe are the beneficiaries of Trust. The Tribe delivers a check monthly to A which represents the appropriate percentage of the gaming revenues specified by the Ordinance. The trustee then divides the amount by the number of Tribe minors or incompetent persons and deposits those amounts in separate named shares for each person.

Section 1.2 of the Trust Agreement provides that Trust is irrevocable and subject to amendment by the Tribe or within the first six months for the sole purpose of bringing Trust into compliance with the Ordinance.

Section 2.2 of the Trust Agreement provides that before a beneficiary reaches the age of eighteen the trustee may make purely discretionary payments from Trust to provide for the proper support, maintenance, health, and education of the beneficiary, taking into consideration the needs, age, health, educational requirements, marital

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status, and other circumstances of the beneficiary, including other sources of financial assistance.

Section 2.3 of the Trust Agreement provides that once the beneficiary reaches the age of eighteen, the trustee can continue to make discretionary payments when required for the proper support of the beneficiary, but in addition, there is a defined distribution schedule, culminating with the distribution of all of the beneficiary's share by the age of 35. Despite this schedule, once a beneficiary reaches eighteen, his or her senior living parent or guardian who is also a Tribe member, has the one time option to accelerate or decelerate the payment schedule in any manner, including an immediate distribution of the entire trust to the beneficiary at age eighteen.

Section 2.4 of the Trust Agreement provides that if the beneficiary dies before the age of 18, his or her share is distributed at the direction of his or her senior living parent or guardian who is also a member of the Tribe. If there is no living member parent to direct the share, it is distributed under the terms of section 2.5.

Section 2.5 of the Trust Agreement provides that if the beneficiary dies before the age of 35, whatever constitutes his or her share shall be paid over to such person as the beneficiary may appoint in his or her will. If the beneficiary fails to exercise the power of appointment, then the share is distributed to his or her living issue per stirpes. Failing the existence of any living issue, his or her share shall be distributed as if the beneficiary died intestate in State A, except that no part or any share may be distributed to a person who is not a member of the Tribe.

Section 2.7 of the Trust Agreement provides that if at any time there is no person living who is entitled to a share, or portion of a share, under the terms of the Trust Agreement, then that share shall be distributed to the Tribe.

Section 2.9 of the Trust Agreement provides that no title in any share shall vest in a beneficiary prior to distribution. Likewise, no beneficiary shall have any power to sell, assign, transfer, encumber, anticipate, or otherwise dispose of his or her interest in a share prior to an actual distribution.

Section 3.2 of the Trust Agreement provides that the Tribe may, at any time, and from time to time, demand that the trustee transfer to the Tribe such asset or assets of any trust or share created under the Trust Agreement as the Tribe shall direct in exchange for an asset or assets of equivalent value. This right may be exercised by the Tribe without the consent of any other person. This right shall be nonfiduciary in nature and its existence and exercise shall not be conditioned upon the identity of the trustee.

Taxpayer represents that Trust participants must maintain membership in the Tribe in order to receive distributions from Trust. If this condition is not met, Trust

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proceeds are distributed back to the Tribe.

LAW AND ANALYSIS

Section 61 defines gross income as income from whatever source derived.

Section 451(a) and § 1.451-1(a) provide generally that gains, profits, and income are includible in gross income for the taxable year in which they are actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting.

Under § 1.451-2(a), income is constructively received by a taxpayer in the taxable year during which it is credited to a taxpayer's account, set apart, or otherwise made available so the taxpayer may draw upon it at any time, or so that the taxpayer could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The doctrine of constructive receipt requires a cash basis taxpayer to recognize income when the taxpayer has an unqualified, vested right to receive immediate payment. Ross v. Commissioner, 169 F.2d 483, 490 (1st Cir. 1948); Amend v. Commissioner, 13 T.C. 178, 185 (1949). In this case, Trust's beneficiaries are not in constructive receipt of funds placed in Trust because they do not have an unqualified, vested right to receive immediate payment of either the funds transferred to the Trust or income earned by the Trust.

In addition to the doctrine of constructive receipt, the facts of the case must be analyzed under the economic benefit doctrine. In Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952), the court held that the amount placed in trust to be paid out to the taxpayer in later years conferred an economic benefit on the taxpayer in the year the trust was funded. In that case, the taxpayer, a corporation president, voluntarily decreased his compensation. In a later year, when the corporation was sound financially, a trust was set up by the board of directors for the benefit of the taxpayer. In determining that funding the trust conferred an economic benefit on the taxpayer in the year the trust was established, the court noted that the employer had made an irrevocable transfer to the trust, the employer had relinquished all control, the taxpayer had an absolute right to the funds that were to be applied for his sole benefit, the funds were beyond the reach of the employer's creditors, the taxpayer's right to the funds was not contingent, and there were no restrictions on the taxpayer's right to assign or otherwise dispose of his interest.

The economic benefit doctrine also has been applied to require inclusion in income of prize winnings when they are irrevocably placed in a fund to be paid to the

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winner at a later date. See Pulsifer v. Commissioner, 64 T.C. 245 (1975); Anastasio v. Commissioner, 67 T.C. 814 (1977); Rev. Rul. 62-74, 1962-1 C.B. 68; and Rev. Rul 67-203, 1967-1 C.B. 105.

Rev. Rul. 83-25, 1983-1 C.B. 116, holds that a minor received the economic benefit of a trust when it was established by court order to receive damages awarded to the minor as a result of a personal injury suit. Under the terms of the trust, the trustee was authorized to distribute funds necessary for the health, education, support, or maintenance of the minor. The trust was not subject to revocation by the minor, but was subject to amendment, modification, or revocation by the court. The trust was to terminate upon the minor reaching the age of 21, at which time the trust would distribute all of its property to him. If the minor died before reaching the age of 21 the trust property would pass to the minor's estate.

The economic benefit doctrine does not apply where the beneficiary's ability to obtain trust amounts are subject to a future condition or forfeiture. For example, the court in Drysdale v. Commissioner, 277 F.2d 413 (6th Cir. 1960) held that the taxpayer did not receive an economic benefit from a trust established by his employer since the taxpayer was restricted by the terms of the trust from exercising any dominion over the funds. The court noted that in Sproull the trust agreement contained no restrictions on the taxpayer's right to assign or otherwise dispose of his interest, while in the case before them the taxpayer's rights were restricted and that this distinction was critical. Id. 418. See also Estate of Harrison v. Commissioner, 62 T.C. 524 (1974) (holding there was no economic benefit where the trust in question contained an implicit condition that if its terms were violated then distributions from the trust would be forfeited).

In the instant case, Trust has various restrictions and conditions that must be satisfied before proceeds will be distributed to beneficiaries. Accordingly, Trust beneficiaries do not derive an economic benefit when amounts are contributed to Trust or as income is earned by Trust.

Section 671 of the Code provides that where a grantor is treated as the owner of any portion of a trust under subpart E, part I, subchapter J, chapter 1 of the Code, there shall be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust (to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against tax of an individual).

Under § 1.671-3(b) of the Income Tax Regulations, if a grantor is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. Section 1.671-3(b)(3) provides that if the grantor is treated as an owner under § 675 because of a power over corpus, then the grantor

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includes both ordinary income and other income allocable to corpus in the portion the grantor is treated as owning.

Under § 675(4) of the Code, the grantor will be treated as the owner of any portion of a trust in which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. Section 675(4)(C) provides that a power to reacquire the trust corpus by substituting other property of an equivalent value is a power of administration.

Under § 1.675-1(b)(4) of the regulations, if a power is not exercisable by a person as trustee, the determination of whether the power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration.

The circumstances surrounding the Trust's administration will determine whether the power of administration is exercisable in a fiduciary or a nonfiduciary capacity. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office of the District Director where the returns are filed. Therefore, we cannot determine at this time whether the Tribe would be treated as the owner of the Trust under § 675(4) of the Code. Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, the Tribe will be treated as the owner of the Trust under § 675.

The ruling contained in this letter is based upon facts and representations submitted by the Taxpayer. Except as specifically addressed herein, no opinion is expressed regarding the tax treatment of the subject transaction under the provisions of any other sections of the Code or regulations that may be applicable thereto.

In accordance with a power of attorney currently on file, we are sending a copy of this letter to your authorized representatives,

A copy of this ruling should be attached to the federal income tax return for the year in which the transaction in question occurs. This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,
Assistant Chief Counsel, (Income Tax & Accounting)
By Linda M. Kroening,
Counsel to the Assistant Chief Counsel (IT&A)

cc: District Director