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November 9, 1998

M:

N:

Tribe:

Plan:

Compact:

Document:

Agreement:

Trust:

State:

a:

b:

c:

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e:

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f:

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Dear

This responds to a letter dated February 12, 1998, submitted on behalf of the Trustee by your authorized representative, requesting a ruling on the income tax consequences relating to the Trust under §§ 61, 671, 673, and 677 of the Internal Revenue Code. The Trustee represents the following facts.

The Trust was established by the Tribe under the Indian Gaming Regulatory Act, 25 U.S.C. 2701 (1988) (the "Act"), for the benefit of M, one of its minor members. The purpose of Trust is to receive, hold, and invest payments made for the benefit of M ("per capita payments"), under the Act and pursuant to the Plan. The Trust conducts no other business activities.

Congress enacted the Act on October 17, 1988. Section 3 of the Act provides that the purpose of the Act is to provide a statutory basis for the operation of gaming by Indian tribes as a means of promoting tribal economic development, self-sufficiency, and strong tribal governments, and to declare that the establishment of independent federal regulatory authority for gaming on Indian lands, the establishment of federal standards for gaming on Indian lands, and the establishment of a National Indian Gaming Commission are necessary to meet congressional concerns regarding gaming and

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to protect such gaming as a means of generating tribal revenue.

Section 11(b)(3) of the Act provides that net revenues from any class II gaming activities conducted or licensed by any Indian tribe may be used to make per capita payments to members of the tribe only if: (A) the Indian tribe has prepared a plan to allocate revenues to uses authorized by § 11(b)(2)(B) of the Act; (B) the plan is approved by the Secretary of the Interior as adequate, particularly with respect to the uses described in clause (i) or (iii) of paragraph (2)(B); (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 tribes notify members of such tax liability when payments are made. Under § 11(d) of the Act, class III gaming activities are lawful on Indian lands if they meet the requirements of § 11(b) of the Act.

On date a, the Tribe entered into the Compact with the State. Subsequently, the Tribe adopted the Plan, which was approved by the Secretary of the Interior. Pursuant to the Plan, g percent of net gaming proceeds are distributed to tribal members as per capita payments. Regarding per capita payments, the Plan specifically provides, in part, that--

Per Capita payments made to minors (under [b] years of age) will be placed in a U.S. Government backed trust fund until they reach the age of [b]. At this time the member may begin receiving their Per Capita Payments but any funds placed in Trust on their behalf shall remain in Trust until the member reaches the age of [c]. At this time the member may withdraw up to [d percent] of the Trust Fund per year but the amount withdrawn shall not exceed \$e per year. A member may continue to withdraw money from this fund at the same yearly rate until the member reaches the age of [f]. Upon reaching the age of [f] the member may withdraw the remaining balance of their Trust Fund.

On date h, the Tribe adopted the Document. The Tribe is the settlor and the sole trustee of each trust created under

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the Document. On date i, N, the mother of M, executed the Agreement ratifying the Document.

The Document and the Agreement create the Trust, which has all the terms and provisions of the Document. The Document provides that "all provisions of this Trust instrument shall be construed, limited, and applied so as to result in compliance with, and shall be subject to the provisions of, the ... Act and/or Plan, including any changes or amendments thereto." The Trust is irrevocable. The Tribe retained the right to modify, alter, or amend the terms and provisions of the Trust, "provided such modification, alteration, or amendment is required under the [Act]."

The sole principal and income beneficiary of each trust created under the Document is the beneficiary named in each trust adoption agreement, which is similar to the Agreement. The sole beneficiary of the Trust is M. If M or any successor beneficiary should die during the term of the Trust, the descendants of the beneficiary, if any, shall receive that beneficiary's share, in trust, for the remaining trust term, as if that descendant were the original beneficiary of the Trust. If any beneficiary shall die without descendants during the term of the Trust, that beneficiary's interest in the Trust shall vest in equal proportion in the other surviving siblings of the beneficiary. If any beneficiary shall die without descendants and without siblings (or descendants of siblings) during the term of the Trust, that beneficiary's interest will revert in the Tribe to be distributed as additional per capita payments under the Act and the Plan.

The term of the Trust will last until the beneficiary attains the age of f, whereupon all the beneficiary's share of corpus and accumulated income, if any, shall be distributed to that beneficiary free of trust. The Tribe has the discretion to terminate the trust prior to the beneficiary attaining the age of f, in whole or in part, if the value of the trust property no longer justifies the expenses of trust management, or the Tribe considers such distribution to be in the best interest of the beneficiary, considering the demonstrated ability of the beneficiary to handle money properly and wisely, to use judgment, prudence, and discretion, and considering any other factors the Tribe may consider relevant.

The income of the beneficiary is accumulated in trust and added to the principal of the trust unless a distribution is made to the beneficiary under other provisions of the trust.

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Accumulated income or principal may be distributed to a beneficiary from that beneficiary's share of income or principal if the Tribe determines that the beneficiary needs resources for her health, education, or welfare, after taking into consideration funds available from other sources known to the Tribe, including financial sources of the beneficiary's parents or legal guardians. For determining what constitutes the health, education, or welfare of a beneficiary, the Document provides detailed standards.

The Document provides that the law of the U.S. and of the Tribe shall govern, control, and apply to the rights, obligations, terms, provisions, and discretions of the settlor, trustee, beneficiaries, and property of the Trust. To the extent not provided for under the laws of the U.S. and of the Tribe, the provisions of State trust law shall otherwise apply to the Trust, except to the extent any provision thereof has been specifically excluded by federal or tribal law. The situs of the Trust is the tribal reservation of the Tribe.

A full per capita share of the net gaming proceeds has been paid into the Trust since its creation. For the Trust's first tax year (j), per capita payments totaling \$k were paid into the Trust. No money was distributed from the Trust in j or m. The Trust filed a j income tax return reflecting all per capita payments, and the \$n of interest income earned thereon, as items of income reported by, and taxable to, the Trust at the Trust's income tax rate. None of the per capita payments or the interest income earned thereon were reported as income by the Trust beneficiary. For year m, the per capita payments made to the Trust totaled \$p, and the Trust's interest and dividend income was \$q.

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

In general, a cash basis taxpayer does not recognize income upon the receipt of property in the form of a promise to pay in the future. However, a cash basis taxpayer is taxed when the taxpayer receives an "economic benefit" from a right to receive property in the future.

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

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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 funds were placed in trust irrevocably for the taxpayer's sole benefit and that the taxpayer had to do nothing further to establish his right to it.

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 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. Rev. Rul. 83-25 further holds that the minor is the owner of the damages; the minor is treated as the grantor of the trust, and under § 677(a), as the owner of the trust because the trust income and corpus is to be distributed to the minor at the discretion of the court, a nonadverse party, or eventually distributed to the minor when the minor turns 21 years old.

Section 671 provides that, where it is specified under subpart E that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust that 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 the tax of an individual.

Section 673 provides that the grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income

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therefrom if, as of the inception of that portion of the trust, the value of that interest exceeds 5 percent of the value of that portion.

In Estate of Cardeza v. U.S., 261 F2d. 423 (3d Cir. 1958), the court held that a reversionary interest in a trust that would have become effective only if the decedent-grantor had survived the current beneficiaries and their issue did not make the grantor's contributions to the trust includable in her gross estate. This holding was reached under a statute providing that property, the transfer of which was intended to take effect at or after the transferor's death, would not be includable in gross estate unless the transferor retained a reversionary interest worth more than 5 percent of the value of the property transferred. The court concluded that a reversion dependent upon the failure of issue is not susceptible to valuation using actuarial principles, and thus, under the rule established in Robinette v. Helvering, 318 U.S. 184 (1943), is considered to have no value.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse; or held or accumulated for future distribution to the grantor or the grantor's spouse.

If M dies before age f, her interest in the Trust vests first in her descendants, and if none is living, then in her siblings. If M has no living descendants or siblings, then her interest vests in the descendants of her siblings. If, upon M's death before age f, no one exists in any of these classes of successor beneficiaries, then the property held in the Trust reverts to the Tribe to be distributed as additional per capita payments to other tribal members. The Tribe has a reversionary interest in the Trust. We have determined, however, that no reasonable assumption exists that would permit the possibility of issue to be ignored or discounted. Thus, because the Tribe's reversionary interest cannot be valued using actuarial principles, we conclude that the value of the Tribe's reversionary interest is zero and that the Tribe should not be considered the owner of the Trust under § 673.

Under § 11(b)(3)(C) of the Act, the Tribe may not provide for per capita payments unless "the interests of minors and

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other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved." The Tribe made the per capita payments to the Trust for M's

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benefit. The Agreement contains numerous provisions protecting the trust beneficiary's interest in the per capita payments.

The Trust is irrevocable and was established for the sole benefit of M. Considering the provisions of the Act, the Plan, and the Document, we conclude that M receives the economic benefit of the per capita payments when they are deposited into the Trust. When the per capita payments are made, M must treat these payments to the Trust, as well as all income earned therefrom, as items of gross income reportable on her individual federal income tax return.

As the owner of the per capita payments deposited in the Trust, M is considered the grantor of the Trust. Under the provisions of the Trust, trust income and corpus are to be distributed to the trust beneficiary at the discretion of a non-adverse party, or held or accumulated for future distribution. We conclude, therefore, that M is the owner of the Trust under § 677(a).

After applying the applicable law to the facts represented, we rule that:

1. M is in receipt of an economic benefit upon the funding of the Trust with the per capita payments, and therefore, under § 61, must include the deposits of the per capita payments in her gross income for the year in which they are made to the trust.
2. For federal income tax purposes, M is treated as the grantor of the Trust.
3. Under § 677, M is the owner of the Trust, and therefore, must include all items of income, deductions, and credits of the Trust in determining her taxable income.

These rulings are conditioned on M and the Trust filing amended returns for year j, properly reflecting M's ownership of the Trust. Except for the specific rulings above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code.

Under the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

JEFF ERICKSON  
Assistant to the Chief,  
Branch 3  
Office of the Assistant  
Chief Counsel  
(Passthroughs and  
Special Industries)

enclosure: copy for § 6110 purposes