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Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: March 18, 2005

November 23, 2004

Section 7873 -- Federal Tax Treatment of Income Derived By Indians From Exercise of Fishing Rights Secured by Treaty, Etc.

7873.00-00 Federal Tax Treatment of Income Derived By Indians From Exercise of Fishing Rights Secured by Treaty, Etc.

CC:TEGE:EOEG:ET2

PLR-136832-04

Legend

X =

Y =

Court Case =

Treaty 1 =

Treaty 2 =

Settlement Agreement =

Identification Number =

River System =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6

Dear *** :

This is in response to your request for a letter ruling dated June 29, 2004, as supplemented on October 14, 2004, in which you requested the following rulings:

That the funds attributable to the Settlement Agreement are, pursuant to [Internal Revenue Code \(Code\) Section 7873\(a\)](#), income derived from a fishing rights-related activity of X, and exempt from Federal income tax.

That the funds attributable to the Settlement Agreement, distributed as per capita payments to X members, will not be "wages" subject to Federal Insurance Contribution Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes upon distribution because such payments are income derived from a fishing-rights-related activity of X under [Code section 7873\(b\)](#), and exempt from Federal employment taxes (*i.e.* FICA and FUTA taxes).

That inasmuch as the funds attributable to the Settlement Agreement, distributed as per capita payments to X members, are exempt from the imposition of federal income taxes pursuant to [Code Section 7873](#), X is not subject to the reporting requirements of [Code section 6041](#) with respect to the amounts distributed.

FACTS

X is a federally recognized Indian Tribe organized and operating under a Constitution

approved by the Secretary of the Interior pursuant to the Indian Reorganization Act of 1934, [25 U.S.C. section 476](#). X is a successor in interest to certain Indian tribes who were parties to Treaty 1 and Treaty 2. See Court Case.

The treaties guarantee X's fishing rights on the River System. Treaty 1 provides in relevant part:

Similarly, Treaty 2 provides in relevant part:

The River System is the "usual and accustomed" grounds for fishery activities for X and its members.

For many years there was a dispute between X and Y over damages to X's fishing rights caused by certain activities of Y on the River System. The activities of Y interfered with and negatively impacted on X's treaty-guaranteed rights and opportunities to harvest and sell fish. A large portion of X's and its members' economic livelihood is dependent on the River System. Y's activities that adversely affected the treaty-guaranteed rights began in 1912.

On Date 1, the Federal Register published a notice by the Bureau of Indian Affairs of the Department of the Interior listing all potential pre-1996 Indian damage claims identified by or presented to the Department of the Interior's Statute of Limitations Program as required by Sec. 3(a) of the Indian Claims Litigation Act of 1982, [Pub. L. 97-394](#). X's claim was given an Identification Number. X supported its treaty-based claim by sending a copy of a complaint drafted in contemplation of litigation and captioned X v. Y. The complaint alleges in pertinent part that Y's activities had "denied Plaintiff access to usual and accustomed tribal fishing grounds, have reduced the number and variety of anadromous fish available for harvest at (other) [FN1] tribal fishing areas, and have taken water reserved for Plaintiff's use thus interfering with property secured to Plaintiff by [Treaties 1 and 2]." The complaint also seeks damages from 1912 when the interference began.

On Date 2, the Tribal Council of X passed a resolution authorizing the Office of the Tribal Attorney to file suit against Y. The resolution recites that X "has claims for damages to its fishing and water resources" because of adverse activities by Y.

On Date 3, Y's Director of Utilities presented the proposed Agreement to the Y City Council, and in a cover letter recited: "This is a comprehensive settlement agreement as it resolves all issues [between X and Y] relating to our current operations on the River System and the proposed ***." On Date 4, the Y City Council resolved to approve the Agreement between X and Y "regarding the Tribe's Treaty Rights to fish and access" the River System.

On Date 5, X and Y entered into a comprehensive Settlement Agreement (Agreement). The Agreement resolves, releases and extinguishes ALL claims past, present and future against [Y] by [X] arising or related to [Y's]" activities on the River System." The Agreement provides a schedule of payments to be made to X by Y over a ***. The total amount of payments to be made is \$ ***. [FN2] These payments are made to extinguish the claims that arise out of its treaty-guaranteed fishing rights. The Agreement provides that X will establish a *** (Fund) into which X may deposit all or a portion of the Payment made by Y pursuant to the Agreement. The Agreement provides that the Fund may be managed in a way to allow for the annual disbursement of funds to X and its members to be spent on meeting the needs of X and its members as determined by X. Moreover, the Agreement provides for fisheries restoration and enhancement, rules for water quality and habitat protection, and other matters relating to the River System.

On Date 6, the X Tribal Council resolved to authorize a per capita distribution of \$ *** from the Fund. The resolution recites that the Agreement was "intended, in part, to settle the Tribe's past, present and future claims against [Y] relating to damage caused to the Tribal treaty-protected fishery." The resolution also recites that the Fund "is intended to compensate the Tribe for past damages to the Tribe's treaty-protected fishing rights and is also intended to be a substitute for future income the Tribe and its members could have earned through exercise of its treaty-protected fishing rights were it not for

[activities of X]" Pursuant to the Tribal Constitution and Bylaws the Tribal Council is empowered to appropriate and expend tribal funds.

LAW

[Code section 61](#) provides that gross income includes income from whatever source derived, subject to certain exceptions.

[Code sections 3101](#) and [3111](#) impose FICA taxes on "wages" as that term is defined in [section 3121\(a\)](#). [Code](#) section 3301 imposes FUTA taxes on "wages" as that term is defined in section 3306(b). Employment taxes consist of FICA taxes and FUTA tax.

[Code section 7873](#) provides rules governing the federal tax treatment of income derived by Indians from the exercise of fishing rights secured by treaty. The general rule of [Code section 7873\(a\)\(1\)](#) provides that no income tax shall be imposed on income derived by a member of an Indian tribe directly or through a qualified Indian entity, or by a qualified Indian entity, from a fishing rights-related activity of such tribe. The general rule of [Code section 7873\(a\)\(2\)](#) provides that no employment taxes shall be imposed on remuneration paid for services performed in a fishing rights-related activity of an Indian tribe by a member of such tribe for another member of such tribe or for a qualified Indian entity.

[Code section 7873\(b\)\(1\)](#) defines "fishing rights-related activity" to mean:

[A]ny activity directly related to harvesting, processing, or transporting fish harvested in the exercise of a recognized fishing right of such tribe or to selling such fish but only if substantially all of such harvesting was performed by members of such tribe.

No regulations have been promulgated under [section 7873](#).

The legislative history of [section 7873](#) provides additional guidance on the term "fishing rights-related activity":

The term "fishing rights-related activity" is defined to include any activity directly related to harvesting (including aquaculture), processing, or transporting fish harvested in the exercise of fishing rights guaranteed by treaty, Federal statute, or executive order, or the selling of such fish, provided that substantially all of the harvesting of such fish was performed by members of the tribe granted such fishing rights.

Senate Report No. 445, 100th Cong., 2d Sess. 474 (August 3, 1988)

It is the intent of the Committee that this legislation be read broadly to clarify the tax exempt status of all fishing activities, regardless of whether they are protected by treaty, executive order, or statute.

House Report No. 312 (Part 1), 100th Cong., 1st Sess. 5 (September 31, 1987)

The Committee intends that the provisions of the legislation shall be liberally construed.

The term "rights to fish" includes the rights to fish for commercial as well as for subsistence purposes. It includes the harvest of all species of fish, shellfish, and other forms of marine life where rights to harvest such fish are secured.

* * *

The Committee intends that the provisions ... shall apply to the fishing rights of any Indian tribe as a tribe, and is also intended to clarify the tax-exempt status of income derived by individual members of the tribe.

Id. at 6.

Legislative history also provides guidance on the definition of "qualified Indian entity." Income earned by a corporation, partnership, or other business entity from fishing rights-related activity also is exempt from Federal income taxes if the entity constitutes a "qualified Indian entity," as defined in the bill.

A footnote to the above recites:

The exemption from tax applies to direct income received by a taxpayer as well as to distributions with respect to an equity interest in a qualified Indian entity to the extent the distribution is attributable to income derived by the entity from fishing rights-related activity.

[Revenue Procedure 2002-64, 2002-2 C.B. 717](#), identifies Indian tribal governments that

are to be treated similarly to states. X is listed as an Indian tribal entity in revenue procedure section 3.01.

Senate Report No. 445, 100th Cong., 2d Sess. 474 (August 3, 1988). Thus, exempt income may be received directly from X as well as a qualified Indian entity.

Whether an amount received as settlement proceeds constitutes wages for FICA, FUTA, and income tax withholding purposes depends on the nature, origin, and character of the claim giving rise to the settlement. In [Hort v. Commissioner, 313 U.S. 28 \(1941\)](#), 1941-1 C.B. 319, the Supreme Court held that in determining whether damages were includible in the recipient's gross income, an examination must be made of the item for which the damages were a substitute. [Revenue Ruling 72-341, 1972-2 C.B. 32](#), held that since payments made by a corporation to its employees as a result of a suit for violation of Title VII of the Civil Rights Act of 1964 were based on compensation they otherwise would have received, the payments are includible in gross income and are "wages" for purposes of the FICA and FUTA taxes and for federal income tax withholding purposes. In general, Code [section 6041](#) requires a person engaged in a trade or business and making a payment in the course of the trade or business of \$600 or more during a calendar year of fixed or determinable income to file an information return with the Internal Revenue Service and to furnish an information statement to the payee.

ANALYSIS

Under the facts of this case Y violated the treaty protected fishing rights of X by activities on the River System that caused an economic loss to X and its members over a substantial period of time. On Date 5 an Agreement was entered into between X and Y which, in part, provided for payments to X in settlement of such treaty violations. Pursuant to that Agreement Y agreed to pay X the sum of \$ *** over a ***, all or a portion of which could be deposited in a Fund for distribution to members of X. The funds deposited by Y into the Fund are intended to replace income that would have been received by tribal members but for Y's violations of X's treaty protected fishing rights on the River System. The income that the settlement funds are intended to replace, i.e., income from fishing which members of X would have received but for Y's interference with X's treaty rights on the River System since 1912, would have been tax exempt pursuant to the rules of [Code section 7873\(a\)\(1\) and \(2\)](#). The settlement of X's claims against Y for treaty violations by payments into the Fund pursuant to the Settlement Agreement does not change the character of the funds to be distributed to X. The nature, origin, and character of the claim giving rise to the settlement are treaty violations that interfered with X's rights to fish on the "usual and accustomed" grounds on the River System and consequently denied X and its members fishing rights-related income. Under the facts of this case the Tribal Council made a resolution to authorize the distribution of \$ *** from the Fund. This money was paid into the Fund pursuant to the Agreement between X and Y. The funds distributed are intended to compensate X's members for past and future damage to X's treaty-protected fishing rights caused by the activities of Y on the River System. The Agreement provides for the disbursement of funds to the members of X to meet the needs of the members of X. Under [Code section 7873](#) income derived by a member of an Indian tribe directly from a fishing rights-related activity of such tribe is exempt from income and self-employment taxes. The funds to be disbursed from the Fund to X members retain their original character as income derived by X and its members from the exercise of fishing rights secured by Treaty 1 and Treaty 2. As such the funds distributed to members of X are equivalent to income derived by members of X directly from a fishing rights-related activity. Inasmuch as funds attributable to the Agreement and distributed as per capita payments to X members are exempt from the imposition of federal income and employment taxes pursuant to [Code section 7873](#), X is not required to file information returns under [Code section 6041](#) and report Settlement Agreement payments made to X members.

CONCLUSION

With regard to ruling request one, funds attributable to the Settlement Agreement are, pursuant to [Code Section 7873](#), income derived from a fishing rights-related activity of X, and exempt from Federal income tax.

With regard to ruling request two, a per capita distribution of funds attributable to the Agreement to members of X, will not be "wages" subject to FICA and FUTA taxes upon distribution because such payments are pursuant to [Section 7873](#), income derived from a fishing rights-related activity of X, and exempt from Federal employment taxes.

With regard to ruling request three, because the funds attributable to the Agreement and distributed as per capita payments to X members are exempt from the imposition of federal income and employment taxes pursuant to [Code Section 7873](#), X is not subject to [Code section 6041](#) reporting requirements with respect to the amounts distributed.

This ruling is directed only to the taxpayer requesting it. [Code section 6110\(k\)\(3\)](#) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lynne Camillo
Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel (Exempt Organizations/Employment
Tax/Government Entities)

cc:

FN1. This parenthetical represents other claims of X against parties not relevant to this determination.

FN2. According to one study developed at the request of the Bureau of Indian Affairs, the estimated economic compensation required to make up for lost fishery opportunities on a part of the River System alone was \$17,710,000. This estimation is stated in "1982 dollars" and is a net value; that is, Indian costs that would presumably have been incurred were netted out of the final value estimates.

This document may not be used or cited as precedent. [Section 6110\(j\)\(3\) of the Internal Revenue Code](#).

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