

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: June 2, 2000

March 8, 2000

Section 451 -- General Rule for Taxable Year of Inclusion (Year Received v. Not Year Received)

451.00-00 General Rule for Taxable Year of Inclusion (Year Received v. Not Year Received)

Section 61 -- Gross Income v. Not Gross Income

61.00-00 Gross Income v. Not Gross Income

Section 675 -- Administrative Powers

675.00-00 Administrative Powers

CC: DOM:P&SI:2 - PLR-114616-98

Band =

Ordinance =

Trust Agreement =

Dear *** :

This responds to your letter dated July 16, 1998, written on behalf of the Band, requesting rulings under [sections 61, 451, and 671 of the Internal Revenue Code](#). The information submitted states that the Band 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. § 476](#). The Band is an Indian tribal government within the meaning of section 7701(a)(40) of the Code. The information further states that the Band conducts gaming pursuant to its self-determination powers 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 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 Band 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 V of the Ordinance provides that per capita payments will only be distributed to enrolled members of the Band. The revenue allocation plan was approved by the Secretary of the Interior.

Section V of the Ordinance requires that the revenue designated to pay per capita payments of minor or incompetent members be placed in irrevocable trusts (the Trusts) administered by an independent institutional trustee. Section II of the Ordinance provides that the Band's 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 Band is named as the donor of the Trusts. The minor or incompetent members of the Band are beneficiaries of the Trusts. The Trusts are to be administered pursuant to the terms of the Trust Agreement.

Section 1.02 of the Trust Agreement provides that it is the Tribal Council's specific intention and direction that the assets of the separate trusts be combined for ease of administration provided that the separate character of the beneficiaries' proportionate shares is preserved.

Section 2.01 of the Trust Agreement provides that the trustee shall accumulate the net income and add such accumulated net income to principal.

Section 2.02 of the Trust Agreement provides that in the case of trusts for minors, the trust assets shall be distributed to the beneficiary, if the beneficiary is then competent, upon application of the beneficiary, providing sufficient evidence of eligibility, approved by the trustee or trustees or the Tribal Council, in accordance with the following schedule: at age 21, twenty-five percent (25%) of the then principal; at age 22, thirty-three percent (33%) of the then principal; at age 23, fifty percent (50%) of the then principal, and at age 24, the remaining assets of the trust. Prior to the time the beneficiary reaches the age of 21, the trustee or trustees, or the Tribal Court, unanimously, in their sole discretion, may make distributions to defray the unreimbursed medical expenses in excess of \$250 incurred by the beneficiary in any one calendar year, provided that the Tribal Council concurs in the determination made by the trustee or trustees. Upon the petition of the parent or legal guardian of the minor, trust assets shall be distributed to the parent or legal guardian of the minor in such amounts as from time to time the trustee or trustees or the Tribal Court unanimously, in their sole discretion, deem necessary for the minor's health, education, or welfare.

Section 2.03 of the Trust Agreement provides that in the case of any of the trusts for any adult Member who has been formally adjudicated to be legally incompetent, the trust assets shall be distributed to the beneficiary upon the petition of the parent or legal guardian of the beneficiary in such amounts as from time to time the trustee or trustees, unanimously, in their sole discretion, deem necessary for the beneficiary's health, education, or welfare.

Section 1.05 of the Trust Agreement provides that the Trusts are irrevocable.

Section 2.04 of the Trust Agreement provides that if any trust assets remain in a trust at the beneficiary's death those assets shall be distributed to his or her surviving children. If there are no surviving children, those assets shall be distributed to his or her surviving parents who are members of the Band. In the absence of either surviving children or surviving parents who are members of the Band the assets revert to the Band.

Section 3.01 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 1.04(4) of the Trust Agreement provides that the Tribal Council shall have the right at any time, and from time to time in its sole discretion to substitute assets of equal fair market value for any asset held by any of the separate trusts; provided, however, that such substitution of assets shall be subject to an independent third party review by a recognized appraiser establishing the fair market value of the substituted assets. This right is exercisable by the Tribal Council in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity.

[Section 61](#) defines gross income as income from whatever source derived.

Section 451(a) and [§ 1.451-1\(a\) of the Income Tax Regulations](#) 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, the Trusts' beneficiaries are not in constructive receipt of funds placed in the Trusts because they do not have an unqualified, vested right to receive immediate payment of either the funds transferred to the Trusts or income earned by the Trusts.

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 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 the amount of damages paid into the registry of a court. The amount of damages was awarded to the minor as a result of a personal injury suit filed on the minor's behalf. Pursuant to a court order, the amount of damages was transferred to a trust for the minor's benefit. 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, the Trusts have various restrictions and conditions that must be satisfied before proceeds will be distributed to beneficiaries. Accordingly, the Trust beneficiaries do not derive an economic benefit when amounts are contributed to the Trusts or as income is earned by the Trusts.

[Section 671](#) 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 section 1.671-3(b), 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 section 675 because of a power over corpus, then the grantor includes both ordinary income and other income allocable to corpus in the portion the grantor is treated as owning.

Under section 675(4), 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), 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 Trusts' 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 Band would be treated as the owner of the Trusts under section 675(4). Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, the Band will be treated as the owner of the Trusts under section 675.

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

1. Neither the creation of the Trusts, nor the contributions of assets to the Trusts, nor the accumulation of income in the Trusts will result in taxable income for the minors or incompetent members of the Band using the cash method of accounting.
2. Benefits payable from the Trusts will be includible in the gross income of the minor or incompetent members in the taxable year or years in which the benefits are actually distributed or otherwise made available.
3. Provided that the circumstances surrounding the Trusts' administration indicate that the power of administration held by the Band over the Trusts (i.e. the power to substitute assets for assets of equivalent value) is exercisable by the Band in a nonfiduciary capacity without the approval or consent of a person in a fiduciary capacity, the Band will be treated as the owner of the Trusts under section 675.
4. Assuming that the Band is treated as the owner of the Trusts under section 675, the Band, which is not subject to federal income tax, shall not be subject to federal income tax on the income of the Trusts nor will there be any tax consequences to the Band upon funding of the Trusts. [Rev. Rul. 94-16, 1994-1 C.B. 19](#); [Rev. Rul. 67-284, 1967-2 C.B. 55](#).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the

Code provides that it may not be used or cited as precedent.
Pursuant to a power of attorney on file in this office, a copy of this letter will be sent to the Band.

Sincerely yours,

J. Thomas Hines
Senior Technician Reviewer, Branch 2
Office of the Assistant Chief Counsel (Passthroughs and Special Industries)

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

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