

## Per Capita Distributions of Funds Held in Trust by the Secretary of the Interior

Notice 2014-17

### **PURPOSE**

This notice provides interim guidance concerning the federal income tax treatment of per capita distributions made to members of Indian tribes from funds held in trust by the Secretary of the Interior.

The Internal Revenue Service (Service) and the Treasury Department are issuing this notice to allow Indian tribes to review the interim guidance and provide comments prior to the issuance of final guidance. Comments may be submitted in writing on or before September 17, 2014. Comments should be submitted to Internal Revenue Service, CC:PA:LPD:PR (Notice 2014-17), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, or electronically to [notice.comments@irs.counsel.treas.gov](mailto:notice.comments@irs.counsel.treas.gov). Please include "Notice 2014-17" in the subject line of any electronic communications. Alternatively, comments may be hand delivered between the hours of 8:00 a.m. and 4:00 p.m. Monday to Friday to CC:PA:LPD:PR (Notice 2014-17), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC. All comments will be available for public inspection and copying.

### **BACKGROUND**

The Department of the Interior (DOI), primarily through the Office of Special Trustee (OST), is responsible for holding in trust certain funds on behalf of individual Indians and federally recognized Indian tribes.

Current DOI regulations under 25 C.F.R. §§ 115.700-701 provide that funds may be accepted by the Secretary of the Interior on behalf of federally recognized Indian tribes and certain individual Indians who have an interest in trust lands, trust resources, or trust assets. Funds accepted on behalf of Indian tribes are deposited into tribal “Trust Accounts” as defined at 25 C.F.R. § 115.002. The OST has the responsibility to manage the funds and make them available to the tribe upon request.

Funds held in tribal Trust Accounts by the DOI may be distributed per capita to members of the tribes. Prior to the enactment of the Per Capita Act, Pub. L. No. 98-64, 97 Stat. 365, 25 U.S.C. §§ 117a-117c, in 1983, the DOI had the sole authority for making per capita distributions out of tribal Trust Accounts. However, the Per Capita Act provided Indian tribes authority to make per capita distributions directly to members of the tribe out of the tribe’s Trust Account.

## **CONSULTATION**

In the spirit of Executive Order 13175, representatives of the Service and the Treasury Department consulted with tribal leaders and members of Indian tribes concerning the federal income tax treatment of per capita distributions made to Indian tribal members from funds held in tribal Trust Accounts. These consultations and conversations were extremely useful in preparing this notice.

## **APPLICABLE PROVISIONS OF LAW**

Section 61(a) of the Internal Revenue Code, 26 U.S.C. § 61, states that, except as otherwise provided by law, gross income means all income from whatever source

derived, including but not limited to compensation, gross income derived from business, and dividends. Under 26 U.S.C. § 61, Congress intends to tax all gains and undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion.

*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), 1955-1 C.B. 207.

Indians are U.S. citizens subject to the requirement to pay income taxes. *Squire v. Capoeman*, 351 U.S. 1 (1956), 1956-1 C.B. 605. There is no provision in the Internal Revenue Code that exempts an individual from the payment of federal income tax solely because he or she is an Indian. Therefore, exemption of Indians from the payment of tax must derive plainly from treaties or agreements with the Indian tribes concerned or an act of Congress. See Rev. Rul. 67-284, 1967-2 C.B. 55.

The Per Capita Act provides authority to Indian tribes to make per capita distributions to members of the tribe out of funds held in a tribal Trust Account. Under 25 U.S.C. § 117a, funds subject to that section may be distributed by either the Secretary of the Interior or, at the request of the governing body of the tribe and subject to the approval of the Secretary of the Interior, the tribe. In practice, proceeds from trust assets or trust resources (both defined at 25 C.F.R. § 115.002) are deposited into a tribal Trust Account for a tribe and that tribe subsequently makes a per capita distribution using funds from that Trust Account.

The Indian Tribal Judgment Funds Use or Distribution Act, Pub. L. No. 93-134, 87 Stat 466, 25 U.S.C. §§ 1401-1408, concerns the distribution of certain judgment funds to Indian tribes. Under 25 U.S.C. § 117b(a), per capita distributions made

pursuant to 25 U.S.C. § 117a are subject to the provisions of 25 U.S.C. § 1407.

Pursuant to 25 U.S.C. § 1407, none of the funds that are distributed per capita or held in trust pursuant to a plan approved under 25 U.S.C. § 1401 *et. seq*, including all interest and investment income accrued on the funds while held in trust, are subject to federal income taxes. See also H.R. Rep. No. 98-230 at 3 (1983), which provides that per capita distributions of tribal trust revenue "shall be subject to the provisions of [25 U.S.C. § 1407] with respect to tax exemptions." However, per capita distributions to tribal members of "net revenues" from Indian gaming activity that are subject to the Indian Gaming Regulatory Act (net gaming revenues) are subject to federal income taxation and are subject to the information reporting and withholding requirements of 26 U.S.C. §§ 6041 and 3402(r). See 25 U.S.C. §§ 2701-2721 and 25 C.F.R. Part 290. Under the Indian Gaming Regulatory Act, net gaming revenues means "gross revenues of an Indian gaming activity less amounts paid out as, or paid for, prizes and total operating expenses, excluding management fees." 25 U.S.C. § 2703(9).

Under 25 C.F.R. § 115.703, the Secretary of the Interior accepts and deposits into tribal Trust Accounts only funds from sources listed in the table in 25 C.F.R. § 115.702. The 25 C.F.R. § 115.702 table provides that the Secretary of the Interior will accept, among other payments, payments resulting from money directly derived from title conveyance or use of trust lands, payments resulting from penalties for trespass on trust lands, and payments resulting from a final order from a court of competent jurisdiction for a cause of action related to trust assets. The Secretary of the Interior

also accepts deposits of funds derived directly from trust lands, restricted fee lands, or trust resources. See 25 C.F.R. § 115.702 for a full list of funds that the Secretary of the Interior accepts and deposits into tribal Trust Accounts.

## **FEDERAL INCOME TAX TREATMENT OF PER CAPITA DISTRIBUTIONS OF TRIBAL TRUST ACCOUNT FUNDS**

### **a. General Rule**

Under 25 U.S.C. § 117b(a) and 25 U.S.C. § 1407, per capita distributions made from funds the Secretary of the Interior holds in a Trust Account for the benefit of a tribe are generally excluded from the gross income of the members of the tribe receiving the per capita distributions. For example, if proceeds from timber sales, an agricultural lease, or a grazing permit are deposited into a tribe's Trust Account and that tribe subsequently makes a per capita distribution using funds from the Trust Account, the per capita distributions are excluded from the tribal members' gross income.

### **b. Exception**

Distributions to tribal members from a tribal Trust Account constitute gross income under 26 U.S.C. § 61 to the members of the tribe receiving the distributions if a Trust Account is used to mischaracterize taxable income as nontaxable per capita distributions. For example, distributions from a tribal Trust Account constitute gross income under 26 U.S.C. § 61 if based on the facts and circumstances the distributions are mischaracterized compensation to tribal members for their services,

mischaracterized distributions of business profits, or mischaracterized gaming revenues.

The following examples illustrate situations in which distributions from a tribal Trust Account are not treated as nontaxable per capita distributions and are included in gross income under 26 U.S.C. § 61.

Example 1 – Mischaracterized Compensation

B is a housing authority established by Tribe C, a federally recognized Indian tribe. The Director and the Assistant Director of B are both members of Tribe C. During each of the 2011, 2012, and 2013 taxable years, the Director and the Assistant Director are each paid bonuses in the amount of \$15x. In the 2014 taxable year, members of Tribe C's Tribal Council authorize per capita distributions out of the tribe's Trust Account in the amount of \$1x to every member of the tribe and an additional \$2x in per capita distributions to every elder in the tribe. In addition, the members of Tribe C's Tribal Council authorize distributions out of the Trust Account to the Director and Assistant Director in the amount of \$15x each, instead of paying bonuses to the Director and the Assistant Director. The distributions of \$15x to the Director and the Assistant Director are mischaracterized compensation and, therefore, are included in their gross income under 26 U.S.C. § 61.

Example 2 – Mischaracterized Distributions of Business Profits

Tribe D is a federally recognized Indian tribe. A group of Tribe D members own Corporation E, an information technology company that provides call center services.

Corporation E's headquarters is located on land held in trust by the Secretary of the Interior for the benefit of Tribe D. Tribe D charges Corporation E rent at fair market value for its headquarters. However, the lease agreement with Tribe D includes a provision whereby Corporation E deposits an amount approximating its net revenues into Tribe D's Trust Account, characterizing the revenue as additional rent.

Subsequently, members of Tribe D's Tribal Council authorize per capita distributions out of the Trust Account in an aggregate amount equal to the purported "additional rent" to the group of Tribe D members who own Corporation E. The distributions of the mischaracterized business profits from the Trust Account constitute gross income under 26 U.S.C. § 61 to the members receiving the distributions.

### Example 3 – Mischaracterized Gaming Revenues

Tribe F is a federally recognized Indian tribe. Tribe F owns all of Corporation G, which owns and operates a casino located on land held in trust by the Secretary of the Interior for the benefit of Tribe F. All of Corporation G's gaming revenues are subject to the Indian Gaming Regulatory Act. Corporation G distributes 50% of its net gaming revenues to Tribe F. Under a lease agreement with Tribe F, Corporation G deposits the remaining 50% of its net gaming revenues into Tribe F's Trust Account, characterizing the deposits as rent for use of the land for the casino. Subsequently, members of Tribe F's Tribal Council authorize per capita distributions to every member of the tribe out of the net gaming revenues that are held in the Trust Account. The distributions out of the Trust Account are mischaracterized gaming revenues. Because per capita distributions

of net gaming revenues are subject to federal income taxation, the distributions constitute gross income under 26 U.S.C. § 61 to the members of the tribe receiving the distributions.

#### **LIMITATION**

This notice applies only to per capita distributions made by the Secretary of the Interior or an Indian tribe out of a tribal Trust Account, as defined at 25 C.F.R. § 115.002. This notice does not affect the federal income taxation of distributions made from individual Indian trust accounts, from which per capita distributions cannot be made. This notice also does not affect the federal income taxation of and withholding from distributions made pursuant to a Revenue Allocation Plan under the Indian Gaming Regulatory Act, Pub. L. No. 100-497, 102 Stat. 2475, 25 U.S.C. §§ 2701-2721.

#### **DRAFTING INFORMATION**

The principal author of this notice is James Martin of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information, please contact Mr. Martin at (202) 317-5800 (not a toll-free call).