

TAM 9747004, 1997 WL 723504 (IRS TAM)

Internal Revenue Service (I.R.S.)

Technical Advice Memorandum

Issue: November 21, 1997

July 25, 1997

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.

TAM-106086-97

Chief, Examination Division

Taxpayers' Names:

Taxpayers' Address:

Taxpayer Identification No.

Years Involved:

Date of Conference:

Legend:

Taxpayers =

Tribe =

State =

ISSUE:

Whether "income derived from a fishing rights-related activity", as used in section 7873, includes per capita payments to Taxpayers (tribal members) from the tribe's settlement of its action for a declaratory judgment prohibiting state regulation of fishing on treaty waters.

CONCLUSION:

Because the amount of the settlement payment to the tribe was intended to approximate the loss of potential fishing income that would result from the state regulation imposed by the settlement agreement, the per capita payments to Taxpayers are "income derived from a fishing rights-related activity" within the meaning of section 7873.

FACTS:

Taxpayers are members of a federally recognized Indian tribe ("Tribe"). Taxpayers were married and filed joint returns for 1988, 1989, and 1990, the tax years at issue. Many members of Tribe engage in the harvesting, processing, and transporting of fish in the exercise of Tribe's rights under an 1854 treaty ("Treaty") between Tribe and the United States. Substantially all of the harvesting of fish is performed by members of Tribe. All of the equity interests in Tribe are owned by its members, and members of Tribe perform substantially all of its management functions. Tribe members are entitled to any distributions of Treaty-related fishing income of Tribe.

In the interests of conserving natural resources, State attempted to regulate the exercise of Treaty rights by Tribe and its members. In response, Tribe filed a civil action against

State, seeking a declaratory judgment that pursuant to Treaty, State had no right to regulate Tribe's fishing, hunting, and gathering activities on territory specified in Treaty. In June 1988, Tribe and State entered into an agreement in settlement of that litigation ("Agreement").

Under the terms of Agreement, Tribe agreed to implement State conservation methods for fishing, hunting, and gathering by Tribe and its members on territory specified in Treaty. In exchange, State agreed to make annual payments to Tribe. The amount of the payments was calculated to compensate Tribe for any potential income reduction resulting from application of the State conservation methods on waters in which Tribe had fishing rights secured as of March 17, 1988, by a treaty between Tribe and the United States. Because the potential income from hunting and gathering was de minimis, it was not factored into the amount of the annual payments.

Pursuant to Agreement, State made annual payments to Tribe in 1988, 1989, and 1990. In each of those years, Tribe distributed a portion of the payments, per capita and as a distribution with respect to equity interests, to Taxpayers and other Tribe members. Tribe issued Forms 1099-MISC for the payments, and Taxpayers reported the payments on their tax returns as miscellaneous income. In 1991, Taxpayers filed amended returns for 1988, 1989, and 1990, claiming that the payments were excludable because they were fishing rights-related income under section 7873.

LAW:

In ordinary affairs of life, not governed by treaties or remedial legislation, Indians are subject to the payment of income taxes as are other citizens. [Squire v. Capoeman, 351 U.S. 1, 6 \(1956\)](#).

[Rev.Rul. 67-284, 1967-2 C.B. 55, 58](#), modified on another issue by [Rev.Rul. 74-13, 1974-1 C.B. 14](#), holds that Indian tribes are not taxable entities. The revenue ruling further holds that tribal income not otherwise exempt from federal income tax is includible in the gross income of the Indian tribal member when distributed to, or constructively received by, the tribal member.

Section 7873 provides an exemption from the imposition of tax for income derived by a tribal member (directly or through a qualified Indian entity) or a qualified Indian entity, from a fishing rights-related activity of the tribe.

"Fishing rights-related activity" is defined by section 7873(b)(1), with respect to an Indian tribe, as any 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 the tribe.

"Recognized fishing rights" is defined by section 7873(b)(2), with respect to an Indian tribe, as fishing rights secured as of March 17, 1988, by a treaty between the tribe and the United States or by an Executive order or an Act of Congress.

"Qualified Indian entity" is defined by section 7873(b)(3)(A) to mean, with respect to an Indian tribe, any entity if (1) the entity is engaged in a fishing rights-related activity of the tribe, (2) all of the equity interests in the entity are owned by qualified Indian tribes, members of such tribes, or their spouses, (3) except as provided in regulations, in the case of an entity that engages in any substantial processing or transporting of fish, 90 percent or more of the annual gross receipts of the entity is derived from fishing rights-related activities of one or more qualified Indian tribes each of which owns at least 10 percent of the equity interests in the entity, and (4) substantially all of the management functions of the entity are performed by members of qualified Indian tribes.

Section 7873(c)(1) provides that any distribution with respect to an equity interest in a qualified Indian entity of an Indian tribe to a member of the tribe is treated as derived by the member from a fishing rights-related activity of the tribe to the extent the distribution is attributable to income derived by the entity from a fishing rights-related activity of the tribe.

Section 7873(c)(2) provides that if, but for that section, all but a de minimis amount derived by an individual through a qualified Indian tribal entity is entitled to the benefits

of section 7873(a)(1), then the entire amount is entitled to the benefits of that section.

ANALYSIS:

Section 7873(b) provides a statutory definition of "fishing rights-related activity", stating that the term means an activity directly related to harvesting, processing, or transporting fish harvested in the exercise of a "recognized fishing right" of the tribe or to selling such fish if "substantially all of the harvesting was performed by members of the tribe". Fishing rights under Treaty are "recognized fishing rights" because they are rights secured before March 17, 1988, by a treaty between a tribe and the United States. Substantially all of the harvesting is performed by members of Tribe.

The primary question in this case is whether the amount paid in settlement of litigation and in consideration for Tribe's agreement to implement State conservation methods is "income derived from a fishing rights-related activity of the tribe", as defined in section 7873(a)(1). The statute does not address whether a payment in settlement of litigation or in exchange for an agreement not to fully exercise fishing rights could be income derived from a fishing rights-related activity. No regulations have been promulgated under section 7873.

The legislative history of section 7873 sheds some light on how to construe "fishing rights-related activity". Specifically, the House and Senate reports state that aquaculture, the cultivation of fish, is a fishing rights-related activity. H.Rep. No. 312 (part 2), 100th Cong., 2d Sess. 7 (1987), S.Rep. No. 445, 100th Cong., 2d Sess. 474 (1988). The reports also suggest that the sale of a boat or other property is not a fishing rights-related activity. H.Rep. No. 312 at 7, n. 14, S.Rep. No. 445 at 474, n. 141. However, the tax treatment of amounts paid from litigation settlement is not discussed.

The annual litigation settlement payments by State to Tribe were in exchange for Tribe's agreement to implement State conservation measures. The settlement amount was calculated to compensate Tribe for any potential income reduction resulting from application of the State conservation methods to fishing rights-related activities of Tribe. In effect, the payments pursuant to Agreement are substitutes for income directly related to harvesting, processing, and transporting fish.

It is well settled that the classification of amounts received in settlement of litigation is determined by the nature and basis of the action settled, and the amounts received in compromise of a claim must be considered as having the same nature as the right compromised. [Hort v. Comm'r, 313 U.S. 28, 31 \(1941\)](#); [Rev.Rul. 72-341, 1972-2 C.B. 32](#); [Rev.Rul. 76-171, 1976-1 C.B. 18](#); [Alexander v. IRS, 72 F.3d 938, 942 \(1st Cir.1995\)](#), aff'g [Alexander v. Comm'r, T.C. Memo. 1995-51](#). Therefore, we conclude that the payments are "income derived from a fishing rights-related activity", within the meaning of section 7873.

A secondary question in this case is whether Taxpayers are subject to federal income tax on the per capita payments they receive when Tribe distributes the settlement payments to its members. Tribe meets the requirements in section 7873(b)(3) for a "qualified Indian entity" because (1) as established above, the settlement payments are income from fishing rights-related activity of a tribe, (2) all of the equity interests in Tribe are owned by Tribe members, and (3) substantially all of the management function of Tribe are performed by Tribe members. In addition, the distributions to Taxpayers meet the requirements of section 7873(c)(1), because the distributions are made with respect to the equity interests of Tribe members in Tribe's income from a fishing rights-related activity, and Tribe is not only a tribe, but is also a qualified Indian entity.

It has been stipulated in this case that the income related to hunting and gathering under Agreement is de minimis. Under section 7873(c)(2)(A), if all but a de minimis amount derived by an individual through a qualified Indian tribal entity is fishing rights-related income described in section 7873(a)(1), then the entire amount is, under section 7873, exempt from tax. Accordingly, under the facts of this case and section 7873, 100% of Tribe's distributions to Taxpayers of settlement payments are exempt from Federal income tax.

A taxpayer may not rely on a technical advice memorandum issued by the Service for another taxpayer. Section 16.01 of [Rev.Proc. 97-2, 1997-1 I.R.B. 80](#). Accordingly, this memorandum may not be relied on by members of other tribes, even though they may have been parties to the settlement agreement.

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

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