

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200733013**

Release Date: 8/17/2007

Index Number: 671.02-00, 7701.03-00, &
646.00-00

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PLR-143287-06

Date:

May 15, 2007

X =

Trust =

Trust Agreement =

a =

b =

c =

d =

Dear :

This letter responds to a letter dated April 25, 2006, submitted on behalf of X and Trust, requesting rulings on several issues arising from the establishment, funding, and potential termination of Trust under § 646 of the Internal Revenue Code and other provisions.

FACTS

In 1971, the Alaska Native Claims Settlement Act of 1971 ("ANCSA"), 43 U.S.C. 1601 et seq., settled the Alaska natives' claims to land and resources. The ANCSA implements the settlement of native Alaskans' aboriginal land claims by providing for the

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conveyance of certain lands and money (Alaska Native Fund, or “ANF”) to Alaska Native Corporations (“ANCs”) established by qualified Alaska natives as compensation.

The ANCSA provides that U.S. citizens with $\frac{1}{4}$ or more of Alaska Indian, Eskimo, or Aleut blood, who were living on December 18, 1971, were qualified to participate in the settlement. The natives who qualified to participate in the settlement were allowed to enroll as stockholders and receive stock (“Settlement Common Stock”) in one of the twelve regional corporations and in one local village corporation created under the act to receive assets.

The ANCSA, as originally enacted, provided that for a period of 20 years after December 18, 1971, the stock, inchoate rights thereto, and any dividends paid or distributions made with respect thereto may not be sold, pledged, subjected to a lien or judgment execution, assigned in present or future, or otherwise alienated. This limitation, however, did not apply to transfers of stock pursuant to a court decree of separation, divorce, or child support; by a stockholder who is a member of a professional organization, association, or board that limits the ability of that stockholder to practice his profession because of holding such stock; or by inter vivos gift to certain family members. The ANCSA also provided that upon the death of any stockholder, ownership of such stock shall be transferred to any person in accordance with the last will and testament of the deceased or under the applicable laws of intestacy, except that during the 20-year period after December 18, 1971, such stock shall carry voting rights only if the holder thereof through inheritance is also an Alaska native.

Subsequent amendments to the ANCSA generally extend beyond December 18, 1981, the alienability restrictions on the Settlement Common Stock of an ANC unless and until the shareholders of the corporation decide to terminate them. 43 U.S.C. § 1629c. If the shareholders vote to terminate the alienation restrictions on the stock, all Settlement Common Stock is canceled as a matter of law and is replaced with unrestricted Replacement Common Stock. 43 U.S.C. § 1606(h)(3). Thereupon, the special character of the corporation as an ANC created under the ANCSA ceases and the corporation becomes a regular domestic corporation subject to regulation under securities laws.

To accommodate the desire of certain ANCs to transfer a portion of their assets out of the corporate form, the Alaska Native Claims Settlement Act Amendment of 1987 authorizes the conveyance of certain assets of an ANC to a state-chartered Settlement Trust. 43 U.S.C. § 1629e. The general purpose of a Settlement Trust is to preserve native heritage and culture and to promote the health, education, and economic welfare of its beneficiaries, the shareholders of the transferor ANC, and their lawful successors. The trust is to be used to insulate permanently land, as well as other assets transferred to it, from the business risks undertaken by the corporation. Such trusts may not

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operate as a business nor may they make a subsequent transfer of land or interests therein except for a reconveyance to the transferor corporation, if such reconveyance is authorized in the trust instrument. 43 U.S.C. § 1629e.

If the board of directors of an ANC adopts a resolution to establish a Settlement Trust, the resolution to establish the trust must be submitted to a vote of the corporation's shareholders for approval. 43 U.S.C. §§ 1629(a)(3) and 1629b(b). The shareholders, however, are not required to approve the conveyance of any assets by the corporation to the trust unless all or substantially all of the assets of the corporation are to be conveyed. 43 U.S.C. § 1629e(a)(1)(B).

Section 646 was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Section 646 addresses several aspects concerning the tax treatment of Alaska Native Settlement Trusts.

The information submitted states that X was incorporated as an ANC pursuant to the ANCSA and Alaska state law. X has approximately a shareholders, predominantly of Alaskan Native descent. On b, X's Board of Directors approved a plan to begin the process of establishing the Trust. If a final proposal to establish the Trust is approved by the board, then the proposal will be submitted to X's shareholders for their approval. Upon approval by the shareholders, X's Board of Directors will begin to fund the Trust.

The Trust Agreement provides that the purpose of the Trust is to promote the health, education, and welfare of the beneficiaries and to preserve the heritage and culture of Alaska Natives by providing periodic distributions to X's elders. Under the Trust Agreement, X will periodically fund the Trust with securities and other allowable forms of assets. The Trust is irrevocable and may not be altered, amended, or terminated except as provided in the Trust Agreement and as required by the ANCSA. The Trust Agreement provides for termination if the Trust distributes all of its net assets, experiences an event that has a materially adverse effect on the Trust objectives, or has no remaining beneficiaries.

The Trust's beneficiaries will be those living individuals who are 65 years old or older and are registered as shareholders of any X Settlement Common Stock. The beneficiaries will not include any residuary or contingent beneficiary. An individual ceases to be a beneficiary of the trust on the date that the individual dies or, if earlier, on the date the individual ceases to own any shares of X Settlement Common Stock. Under the Trust Agreement, if X stock becomes freely alienable, then no person shall obtain the status of beneficiary unless the individual (1) meets the definition of "Native" or "Descendent of a Native," as provided by 43 U.S.C. § 1602(b), (r); or (2) receives the individual's stock interest pursuant to 43 U.S.C. § 1606(h)(2).

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The Trust Agreement also provides that the trustees shall distribute to the beneficiaries on an annual basis all contributions to or income of the trust (net of liabilities and reasonable amounts for anticipated expenses). The trustees shall have discretion to choose the date for such distributions to be made, provided the annual distributions are made within sixty five days of the end of the Trust's fiscal year. Each person who, as of the date selected by the trustees, meets the definition of beneficiary shall receive an equal share of the Trust's distribution. Each beneficiary may, by delivering an executed and completed form, disclaim any right to a future distribution or set of future distributions from the Trust. The disclaimer will extinguish all legal right of the beneficiary to the distributions disclaimed. A spendthrift provision in the agreement prohibits a beneficiary from selling, assigning, hypothecating or transferring any interest in the Trust.

Under the Trust Agreement, X may transfer additional assets to the Trust that are specially designated as an endowment. In such a case, the trustees shall invest such assets and distribute the earnings, less expected expenses, to the beneficiaries on an annual basis. Such an annual distribution shall not preclude an additional distribution as described above in the same year.

The Trust Agreement provides that there shall be 4 trustees. Only natural persons are permitted to serve as trustees, at least two of whom must be members of X's Board of Directors at the time of their appointments, and at least one of whom must be a resident of Alaska. X's Board of Directors will appoint successor trustees pursuant to the Trust Agreement. However, if X is merged, dissolved, or consolidated, or if X's shareholders vote to terminate the alienation restrictions on the X Settlement Common Stock, but the trust does not terminate, the continuing trustees will appoint their own successors. If federal or local law does not permit the trustees to appoint their successors, X's Board of Directors will continue to appoint the trustees, unless X no longer exists. If X no longer exists, but there is a successor ANC corporation, the successor ANC will appoint the trustees. If there is no successor ANC, the trustees will hold office indefinitely. X's Board of Directors (or the trustees if empowered to fill vacancies pursuant to the agreement) has the power to remove any trustee for cause.

The trustees are prohibited from exercising any power primarily for the benefit of X or its affiliates, rather than for the benefit of the Trust's beneficiaries. The trustees are also prohibited from operating a business within the Trust.

The Trust Agreement provides that except as provided in 43 U.S.C. § 1629e(c), the Trust assets are not subject to the claims of the creditors of X or to satisfy any liabilities of X.

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X represents that: (1) any transfer to the Trust will consist of less than substantially all of X's assets so that the shareholders will not be required to approve the conveyance of assets to the Trust; (2) at the time of the transfer of any assets to the Trust, the transfer will not render X unable to satisfy claims based upon 43 U.S.C. § 1629e(c)(1), (2), or (3), render X insolvent, or occur when X is insolvent; (3) after any transfer of assets to the Trust, the assets retained by X will be more than adequate to meet its obligations; and (4) the Trust will make the election under § 646(c) to have the provisions of § 646 apply to the Trust.

LAW & DISCUSSION

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that, in general, an arrangement will be treated as a trust under the Code if the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Based on the facts and circumstances of this case, and in light of the Congressional purpose expressed in the governing federal statute concerning settlement trusts, the Trust is properly classified as a trust described in § 301.7701-4(a).

Section 646(a) provides that if a § 646 election is in effect with respect to any Settlement Trust, the provisions of § 646 shall apply in determining the income tax treatment of the Settlement Trust and its beneficiaries with respect to the Settlement Trust. Provided that the Trust meets all the requirements to be a Settlement Trust, including making the necessary election under § 646(c), we conclude that § 646 governs the income tax treatment of the Trust. Accordingly, subpart E of part 1 of subchapter J of chapter 1 of the Code (the grantor trust provisions) will not govern the income tax treatment of the Trust during any period that the § 646 election is in effect for the Trust.

Additionally, X requests a ruling that the Trust is not a grantor trust under subpart E for any period during which the § 646 election is not in effect for the Trust. Section 646 will sunset on December 10, 2010, if not extended; thus, it is necessary to determine whether the Trust would be a grantor trust under subpart E after the sunset of § 646. The following analysis and conclusions are based on current provisions of the Code, which provisions may or may not be applicable after the sunset of § 646.

Section 671 provides, in general, that if the grantor of a trust or another person is treated as the owner of any portion of the trust, that person's taxable income and credits shall include the income, deductions, and credits of the trust attributable to that portion

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of the trust to the extent that such items would be considered in computing the taxable income or credits of an individual.

Sections 673 through 678 specify circumstances under which the grantor or another person will be regarded as the owner of a portion of the trust. The Trust Agreement, as currently drafted, reveals none of the circumstances that would cause the grantor or any other person to be treated as the owner of any portion of the Trust under §§ 673, 674, 676, or 678.

Under § 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercised primarily for the benefit of the grantor rather than the beneficiary of the trust.

Our examination of the Trust Agreement, as currently draft, reveals none of the circumstances that cause administrative controls to be considered exercisable primarily for the benefit of the grantor under § 675. Thus, the circumstances attendant on the operation of the Trust will determine whether the grantor will be treated as the owner of any portion of the Trust under § 675. This is a question of fact, the determination of which must be made by the Office of the Area Director with which the parties file their tax returns.

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

Section 677(a)-1(d) of the Income Tax Regulations provides that a grantor shall be treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Assets held by a Settlement Trust may not be used to satisfy the debts of an ANC unless those assets were encumbered before their conveyance to the Settlement Trust, or their conveyance rendered the corporation insolvent or occurred when the corporation was insolvent. 43 U.S.C. § 1629e(c)(5). X has represented that it will not transfer assets to the trust that were encumbered before being transferred, that render X insolvent, or that are transferred while X is insolvent. In addition, the Trust Agreement provides that any conveyance in violation of 43 U.S.C. § 1629e shall be void and any asset so transferred shall not be included in the "Trust Estate." Therefore, based on all

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the facts and circumstances, including X's representations, X will not be treated as the owner of any portion of the Trust under § 677.

Section 301(a) provides, in general, that except as otherwise provided, a distribution of property made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in § 301(c). Under §§ 301(c) and 316, the distribution shall be taxable as a dividend to the extent of the earnings and profits of the distributing corporation.

Section 301(d) provides that the basis of property received in a distribution to which § 301(a) applies shall be the fair market value of such property.

Section 311(b) provides that if a corporation distributes property (other than an obligation of the corporation) to a shareholder in a distribution to which subpart A applies, and the fair market value of the property exceeds its adjusted basis (in the hands of the distributing corporation), then gain shall be recognized to the distributing corporation as if such property were sold to the distributee for its fair market value.

Section 646(d)(1) provides that in the case of an electing Settlement Trust, no amount shall be includible in the gross income of a beneficiary of such trust by reason of a contribution to the trust.

Section 646(d)(2) provides that the earnings and profits of the sponsoring Native Corporation shall not be reduced on account of any contribution to such Settlement Trust.

646(g) provides that the taxable income of an electing Settlement Trust shall be determined under § 641(b) without regard to any deduction under §§ 651 or 661.

Section 1015(b) provides that if property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer under the laws applicable to the year in which the transfer was made.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and

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whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which the property was held by any other person, if under chapter 1 of the Code such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

Provided that the Trust meets all the requirements to be a Settlement Trust, including making the necessary election under § 646(c), we conclude that no amount shall be included in the gross income of X's shareholders or Trust's beneficiaries when X contributes property (including cash) to the Trust. Section 646(d)(1). In addition, X's contributions to the Trust do not constitute gross income to the Trust.

X must recognize gain on any property (including ANCSA land) contributed to the Trust that has a fair market value in excess of its basis, in an amount equal to the excess of its fair market value over its adjusted basis. Section 311(b). The basis of such property in the hands of the Trust shall be equal to its fair market value on the day the property is contributed to the Trust. Section 301(d). The Trust's holding period for this property begins on the day the Trust receives the property. Cf. § 1223(2).

Property that is contributed to the Trust that is not subject to § 311(b), as provided above, must be treated as property transferred to the Trust subject to § 1015(b), so that X's basis in such property carries over to the Trust. Section 1015(b). Additionally, the Trust's holding period shall include the period for which X held those assets. Section 1223(2).

Section 646(i) provides that any loss that would otherwise be recognized by a shareholder upon the disposition of a share of stock of a sponsoring Native Corporation shall be reduced (but not below zero) by the per share loss adjustment factor. The per share loss adjustment factor shall be the aggregate of all contributions to all electing Settlement Trusts sponsored by such Native Corporation made on or after the first day each trust is treated as an electing Settlement Trust expressed on a per share basis and determined as of the day of each such contribution.

Since any loss allowed on the distribution of ANC stock must be reduced by the aggregate of all contributions, expressed on a per share basis, a reduction of basis in X stock at the time X makes contributions to the Trust is not appropriate. Therefore, an X shareholder's basis in X stock will not be reduced by reason of contributions made to the Trust. Section 646(i).

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Section 901(a) of EGTRRA provides a “sunset” provision that all provisions, and amendments thereto, of EGTRRA shall not apply (1) to taxable, plan, or limitation years beginning after December 31, 2010, or (2) in the case of title V, to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010. The legislative history states that for such taxable years beginning after December 31, 2010, the tax consequences of any election previously made under § 646, and any right to make a future election, shall be terminated. Furthermore, any electing Trust then in existence, its beneficiaries, and the sponsoring ANC shall be taxed under provisions of law in effect immediately prior to the enactment of § 646. H.R. Conf. Rep. No. 107-84, at 305 (2001). Therefore, we conclude that the sunset provision of § 646 will not be treated as causing a taxable distribution from X to the Trust or its beneficiaries, or to X’s shareholders, with respect to any contributions made by X to the Trust during any years for which the Trust has a § 646 election in effect.

Section 646(b)(1) provides that there is imposed on the taxable income of an electing Settlement Trust, other than its net capital gain, a tax at the lowest specified rate in § 1(c).

Section 646(b)(2) provides that in the case of an electing Settlement Trust with a net capital gain for the taxable year, a tax is imposed on such gain at a rate of tax that would apply to such gain if the taxpayer were subject to a tax on its other taxable income at only the lowest rate specified in § 1(c).

Section 1(c) provides that there is imposed on the taxable income of every individual who is not a married individual, a tax of 15 percent of taxable income if the taxable income is not over \$22,100.

Section 1(i)(1)(A) provides that in the case of taxable years beginning after December 31, 2000, (i) the rate of tax under § 1(c) on taxable income not over the initial bracket amount shall be 10 percent and (ii) the 15 percent rate of tax shall apply only to taxable income over the initial bracket amount (as defined in § 1(i)(1)(B)(iii)) but not over the maximum dollar amount of the 15 percent rate bracket.

Section 1(h) provides rules concerning the maximum capital gains rate.

The legislative history of § 646 states that “[a]n electing Trust will pay tax on its income at the lowest rate specified for ordinary income of an individual (or corresponding lower capital gains rate).” H.R. Conf. Rep. No. 107-84, at 301 (2001). Accordingly, we interpret the provisions of § 646(b) to provide that the aggregate tax imposed by § 646(b) on the taxable income of an electing Settlement Trust (including its net capital gain) is no greater than an amount equal to the lowest rate specified in

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§ 1(c), taking into account all relevant provisions of the Code (including § 1(i)), applied to such taxable income. Moreover, when there is a net capital gain, the effect of the provisions of § 1(h) could result in a lesser tax on the net capital gain, such as where there is qualified 5-year gain.

Provided that an election under § 646(c) is properly made with respect to the Trust, and such election has not ceased to apply, we conclude that the tax rate imposed upon the Trust, other than net capital gains, will be the lowest rate under § 1(c), taking into account all relevant provisions of the Code, including § 1(i). Additionally, we conclude that the tax imposed on the net capital gain of the Trust (taking into account the provisions of § 1(h)) is at the rate of tax that would apply to such gain if the Trust were subject to a tax on its other taxable income at only the lowest rate specified in § 1(c), taking into account all relevant provisions of the Code (including § 1(i)).

CONCLUSIONS

Accordingly, based solely on the facts submitted and the representations made in this ruling request, and viewed in light of the applicable law and regulations, we rule as follows:

1. The Trust will be classified as a trust for federal tax purposes and is not an association or a partnership and is a separate entity for federal tax purposes. Section 301.7701-4(a).
2. The income tax treatment of the Trust will be governed by § 646 for any taxable years for which the trust has a § 646 election in effect. Section 646(a).
3. Neither X nor any other person will be treated for federal income tax purposes as the owner of the Trust or any portion of the Trust under current §§ 673 through 678 for any taxable years for which the Trust does not have a § 646 election in effect. (e.g., after the sunset of § 646).
4. No amount will be included in the gross income of X's shareholders or Trust's beneficiaries when X contributes property (including cash) to the Trust. Section 646(d)(1).
5. X's contributions to the Trust will not constitute gross income to the Trust.
6. X will recognize gain on any property (including ANCSA land) contributed to the Trust that has a fair market value in excess of its basis, in an amount equal to the excess of the property's fair market value over its adjusted basis for X. Section 311(b). The basis of such property in the hands of the Trust will be equal to its

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fair market value on the day the property is contributed to the Trust. Section 301(d). The Trust's holding period for the property will begin on the day the Trust receives the property. Cf. § 1223(2).

7. Except as provided above in Ruling 6, property transferred to the Trust will be treated as property transferred to the Trust subject to § 1015(b), so that X's basis in such property will carry over to the Trust. Section 1015(b). Additionally, the Trust's holding period will include the period for which X held those assets. Section 1223(2).
8. An X shareholder's basis in X stock will not be reduced by reason of the contributions made to the Trust. Section 646(i).
9. The sunset of § 646 will not be treated as causing a taxable distribution from X to the Trust or its beneficiaries, or to X's shareholders, with respect to any contributions made by X to the Trust during any years for which the Trust has a valid § 646 election in effect.
10. The tax rate imposed upon the Trust's income, other than net capital gains, will be the lowest rate under § 1(c), taking into account all relevant provisions of the Code (including § 1(i)).
11. Tax imposed on the net capital gain of the Trust (taking into account the provisions of § 1(h)) will be at the rate of tax that would apply to such gain if the Trust were subject to a tax on its other taxable income at only the lowest rate specified in § 1(c), taking into account all relevant provisions of the Code (including § 1(i)).

Except as specifically set forth above, we express or imply no opinion as to the federal tax consequences of the transaction described above under any other provisions of the Code. Additionally, with the exception of Rulings 1, 3, and 9, the above rulings are conditioned upon an election under § 646(c) having been properly made with respect to the Trust and such election remaining in effect and not ceasing to apply.

Under a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representatives.

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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,

/s/

JAMES A. QUINN
Senior Technician Reviewer (Acting), Branch 2
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: copy of this letter for § 6110 purposes