

INTERNAL REVENUE SERVICE
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November 17, 1998

C =
D1 =
D2 =
Year 1 =
Trust Agreement =

Dear

This responds to your letter dated January 7, 1998, and prior correspondence, written on behalf of the , requesting rulings under sections 61, 451, and 677 of the Internal Revenue Code.

The information submitted states that the 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 is an Indian tribal government within the meaning of section 7701(a)(40) of the Code.

The information further states that the _____ conducts gaming pursuant to its self-determination powers and pursuant to federal common law and the Indian Gaming Regulatory Act, 25 U.S.C. §§ 2701 et seq. ("IGRA"), enacted by Congress in 1988. The Tribal Council of the _____ enacted the _____ which governs the allocation of the _____ available net revenues from gaming. The _____ submitted the _____ to the Bureau of Indian Affairs (BIA) Area Director for the C Area for review and approval under BIA guidelines. On D1, the BIA approved the _____ as required by IGRA, and on D2, the BIA approved amendments to the _____. The _____ provides for current per capita benefits to be paid to qualified tribal members and provides for deferred per capita benefits to be paid in the future to qualified tribal members.

Pursuant to the authority granted by the _____, the Tribal Council established two deferred benefit plans, Plans A and B (the "Plans"), for adult members meeting certain eligibility criteria.

Under Plan A, a member shall be eligible for deferred per capita benefits if the member has available from earnings or other sources income of at least \$25,000 for the benefit year in question, and the Tribal Council or its designee determine that it is appropriate and in the member's long term best interests to receive deferred benefits in lieu of current benefits so that there is a source of funds available to the member or his or her heirs when the member reaches old age, becomes disabled, or dies. A member wishing to participate in Plan A for a benefit year must, at the time of filing his or her application for deferred benefits, elect payment in accordance with any of the following schedules: (a)(i) a lump sum or (ii) ten annual installments beginning within 30 days after the date that the member becomes permanently and totally disabled, (b)(i) a lump sum or (ii) ten annual installments beginning within 30 days after the date that the member reaches the age of 65, or (c) a lump sum within 30 days after the death of the member.

Under Plan B, a member shall be eligible to participate in Plan B for a benefit year if the member validly elects to receive deferred benefits. A member wishing to participate in Plan B for a benefit year shall, at the time of filing his or her application for deferred benefits, elect payment in accordance with any one of the following schedules: (a)(i) a lump sum or (ii) ten annual installments beginning on December 15 in the year ten years after the benefit year, (b)(i) a lump sum or (ii) ten annual installments beginning on December 15 in the year fifteen

years after the benefit year, or (c) a lump sum within 30 days after the death of the member.

In order to qualify for deferred per capita benefits for any benefit year, the member must timely file an application for deferred benefits for the year containing information required by the Tribal Council. An application, once filed, is irrevocable and binding, subject to the eligibility determination required to be made by the Tribal Council or its designee under Plan A. The member must make his or her payment election, also irrevocable and binding, as part of the application for benefits. A new application for deferred benefits is required for each benefit year.

Applications for deferred benefits must be filed before _____ in the year preceding the benefit year, before the net revenues comprising the benefits are earned by the _____.

The Tribal Council, in its sole discretion, may make distributions under the Plans in advance of the date(s) elected by the participant only in the event of an unforeseeable emergency. For this purpose, "unforeseeable emergency" shall mean only severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant or of a dependent of the participant (with "dependent" defined in section 152(a) of the Internal Revenue Code of 1986, as amended, or any successor provision), loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant. The circumstances that will constitute an unforeseeable emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that such hardship is or may be relieved (a) through reimbursement or compensation by insurance or otherwise, (b) by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or (c) by cessation of deferrals in future years under the Plans. Examples of what are not considered to be unforeseeable emergencies include the need to send a participant's child to college or the desire to purchase a home. Withdrawals of amounts because of an unforeseeable emergency must only be permitted to the extent reasonably needed to satisfy the emergency need.

If a participant dies before all or any deferred benefits have been paid to the participant in accordance with the payment schedule elected by the participant, such unpaid benefits shall be paid in a lump sum to the participant's estate. However, if a

member who has applied for deferred benefits dies before of the benefit year, the member shall not be entitled to any benefits for that year.

Pursuant to authority granted under the , the Tribal Council created one or more trusts as a vehicle for segregation and investment of funds from which benefits may be paid to participants in the Plans ("Plan Trusts"). A bookkeeping account shall be established by the for each participant in the Plans, to which will be credited any per capita benefits set aside for future payment to the participant under the Plans, along with an adjustment made at least quarterly equal to the return (positive or negative) experienced by the benchmark investment or investments selected by the participant from among the group of benchmark investments that will be identified by the , and from which will be subtracted any distributions to the participant.

Deferred per capita benefits may be paid directly by the or from the Plan Trusts. The participants in the Plans shall not have any secured or preferred interest by way of a trust, escrow, lien, or otherwise in any specific asset of the for payment of unpaid benefits under the Plans. However, participants will have an enforceable contract right against the for payment of benefits. It is represented that although the per capita benefits paid pursuant to the Plans are not being paid to the participants as compensation, the Plan Trusts nevertheless conform substantially to the terms of the model trust described in Rev. Proc. 92-64, 1992-2 C.B. 422, for use in executive compensation arrangements.

Benefits for each participant in Plans A and B have been contributed to the Plan Trusts by the on for each benefit year beginning in Year 1.

Section 61 of the Code defines gross income as income from whatever source derived.

Section 451(a) of the Code and section 1.451-1(a) of the Income Tax Regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting.

Under section 1.451-2(a) of the regulations, income is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time.

However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Rev. Rul. 60-31, 1960-1 C.B. 174, modified by Rev. Rul. 64-279, 1964-2 C.B. 121, and by Rev. Rul. 70-435, 1970-2 C.B. 100, considers the application of the constructive receipt doctrine to various situations involving deferred compensation and holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income under the cash method of accounting. In situation 3 of Rev. Rul. 60-31, royalties deferred by an election made before the royalties were earned are held includible in gross income when actually received. Rev. Rul. 69-650, 1969-2 C.B. 106, holds that where an employee elected by December 31 to defer a portion of salary to be earned in the following year, the salary so deferred is not includible in gross income for the year earned, but for the year in which actually received or made available.

In the present case, the adult member who elects deferred benefits will not actually receive any cash or property under a Plan until the amounts are in fact paid to the member under the payment schedule selected. The member will not constructively receive any income because the member is not able to draw upon any amounts placed in trust. The member must irrevocably elect deferred payment of benefits under each Plan prior to the time the funds used to pay the per capita benefits are earned. In addition, the member holds a mere contractual obligation from the to pay deferred benefits and the member does not have a security interest in any assets of the or any Plan Trust used to fund benefits.

Separate from the concept of constructive receipt is the economic benefit doctrine. If the economic benefit doctrine applies, income is taxable under section 61 of the Code, even though it is not actually or constructively received in cash form. Under the economic benefit doctrine, a taxpayer must include in gross income any economic or financial benefit derived from the absolute right to income in the form of a fund which has been irrevocably set aside for him in trust and is beyond the reach of the payor's creditors. See Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd. per curiam, 194 F.2d 541 (6th Cir. 1952). The doctrine has been applied to deferred payment arrangements in both employment and non-employment contexts. In non-employment situations, economic benefit results when prizes and winnings have been put in escrow or paid to another party. See Anastasio v. Commissioner, 67 T.C. 814 (1977), aff'd, 78-1 USTC para. 9153 (2d Cir. 1978); Pulsifer v. Commissioner, 64 T.C. 245 (1975);

Rev. 62-74, 1962-1 C.B. 68; and Rev. Rul. 67-203, 1967-1 C.B. 105. The doctrine also applies where a personal injury award is put into trust for a minor. Rev. Rul. 83-25, 1983-1 C.B. 116.

Section 1 of the Trust Agreement provides that any funds placed in a Plan Trust will be subject to the claims of the general creditors under federal, state, or local law in the event of the insolvency. Therefore, the adult members will not have received an economic benefit requiring inclusion of amounts in income upon the funding of a Plan Trust or as income is earned on amounts in the trust.

Section 671 of the Code provides that where a grantor shall be 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).

Section 677(a)(2) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) of the regulations provides that under section 677 of the Code, a grantor is, in general, 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.

Provided that the provisions of the Trust Agreement requiring the use of trust assets to satisfy claims of general creditors of the in the event of its insolvency are enforceable by its creditors under federal, state, or tribal law, and based on the information submitted and representations made, we conclude:

1. Neither the creation of the Plans, nor the contributions of per capita benefits to the Plan Trusts, nor the accumulation of income in the Plan Trusts will result in taxable income for the participants in the Plans using the cash method of accounting.

2. Because the principal and income of the Plan Trusts may be applied in discharge of legal obligations of the _____, the _____ shall be treated as the owner of the Plan Trusts under section 677 of the Code. The _____, which is not subject to federal income tax, shall not be subject to federal income tax on the income of the Plan Trusts. Rev. Rul. 94-16, 1994-1 C.B. 19; Rev. Rul. 67-284, 1967-2 C.B. 55.

3. All benefits payable pursuant to the Plans will be includible in the gross income of the participants in the Plans in the taxable year or years in which the benefits are actually distributed or otherwise made available pursuant to the terms of the Plans.

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 _____.

Sincerely yours,

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

Enclosures: 2

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