

Interim Guidance On The Federal Income Tax Treatment Of Indian Tribal Funds Held In Trust By The Secretary Of The Interior, March 10, 2014

<http://www.irs.gov/Government-Entities/Indian-Tribal-Governments>

HIGHLIGHTS:

- The Notice provides that the IRS and Treasury will treat eligible per capita distributions, made from funds the Secretary of the Interior holds, in a tribal trust account, as generally excluded from the gross income of the tribal members who receive the distributions.
- The Notice also provides, however, that distributions to tribal members from a trust account constitute gross income to the members if the trust account is used to mischaracterize taxable income as nontaxable per capita distributions.

On March 10, 2014, the Internal Revenue Service (IRS) and the Department of Treasury (Treasury) issued [Notice 2014-17](#) (the Notice), which contains interim guidance on the federal income tax treatment of funds held in trust by the Secretary of the Interior. The Notice provides that the IRS and Treasury will treat eligible per capita distributions, made from funds the Secretary of the Interior holds in a trust account for the benefit of a tribe (a tribal trust account), as generally excluded from the gross income of the tribal members who receive the distributions. The Notice also provides, however, that distributions to tribal members from a trust account constitute gross income to the members if the trust account is used to mischaracterize taxable income as nontaxable per capita distributions. The IRS and Treasury will issue final guidance after reviewing comments, which are due on or before Sept. 17, 2014.

Tribal Trust Account Distributions: Tax Considerations

Evaluating the federal income tax treatment of distributions from tribal trust accounts involves three separate, but related, statutes:

- Section 61 of the Internal Revenue Code (26 U.S.C. §61)
- Per Capita Act (25 U.S.C. §§117a-c)
- Indian Tribal Judgment Funds Use or Distribution Act (26 U.S.C. §§1401-1408)

Under Section 61 of the Internal Revenue Code and related case law, gross income includes all income from whatever source derived (including compensation and business profits), unless an exception applies. The Per Capita Act provides authority to Indian tribes to make per capita distributions to their members out of tribal trust accounts. The Per Capita Act also provides that these payments "are subject to" the Tribal Judgment Funds Act, which includes an exclusion from gross income for certain judgment funds and for all interest and investment income accrued on these funds while held in trust.

In September 2012, the IRS issued [Notice 2012-60](#), which addressed the federal income tax treatment of per capita payments made from the proceeds of settlements of certain Indian tribal trust claims. Although Notice 2012-60 primarily relates to the more than \$1 billion settlement the United States entered into with 41 tribes in April 2012, shortly after the release of the guidance,

the IRS indicated that the principles applied in Notice 2012-60 could have broader implications for other types of per capita. During a House Subcommittee on Natural Resources hearing on the tax treatment of tribal resource payments, the members of the subcommittee criticized the legal position taken by local IRS offices seeking to impose taxation on per capita distributions of certain tribal trust resource payments, such as income from tribal timber resources. At that meeting, a senior IRS official indicated that the IRS would apply the "legal underpinnings" articulated in Notice 2012-60 to future guidance that would clarify that per capita distributions of tribal trust resources are exempt from federal income taxation. Notice 2014-17 is a preliminary and interim version of that guidance.

Provisions of Notice 2014-17

The Notice provides that, under the Per Capita Act and the Tribal Judgment Funds Act,¹ per capita distributions made from tribal trust accounts are generally excluded from the gross income of the members of the tribe receiving per capita distributions. As examples of this general rule, the Notice states that if proceeds from timber sales, an agricultural lease or a grazing permit are deposited into a tribe's trust account, and if the tribe subsequently makes a per capita distribution to its members from these funds, the per capita distributions are excluded from the members' gross income.

The key to the exclusion appears to be whether the funds are accepted by the Secretary of the Interior into a tribal trust account. By way of background, the IRS notes that under 25 CFR §115.703, the Interior accepts and deposits into tribal trust accounts only funds from sources listed in the table in 25 C.F.R. 115.702, and that table includes references to "money directly derived from title conveyance or use of trust land, payments resulting from penalties for trespass on trust lands, and payments resulting from a final order of a court of competent jurisdiction for a cause of action related to trust assets." (Note: The table in 25 C.F.R. 115.702 also specifically lists "money directly derived from the sale or use of restricted fee land or trust resources," certain self-governance contracting revenues, interest earned on trust fund deposits, and funds derived directly from trust land, restricted fee lands or trust resources by third parties on behalf of the tribe.)

The Notice provides, however, that even if the per capita distribution is from a tribal trust account (that presumably is subject to the rules in 25 C.F.R. 115.703), the distribution might still constitute gross income to the members if, based on the facts and circumstances, "a Trust Account is used to mischaracterize taxable income as nontaxable per capita distributions."

The Notice provides three examples of situations in which distributions from a tribal trust account will not be treated as nontaxable per capita distributions by the IRS notwithstanding Interior's acceptance of the underlying revenue into a tribal trust account:

1. mischaracterized compensation
2. mischaracterized distributions of business profits
3. mischaracterized gaming revenues

Mischaracterized Compensation

In the first hypothetical example presented by the IRS in the Notice, the director and assistant director of a housing authority established by an Indian tribe receive bonuses of \$15x in 2011, 2012 and 2013. In 2014, the tribe makes per capita distributions from its trust account in the amount of \$1x and an additional \$2x in per capita distributions to its elder members. In addition, instead of paying bonus compensation to its staff, the tribe distributes \$15x from the trust account to the director and assistant director of the housing authority. The Notice states that the \$15x distributions to the director and the assistant director are mischaracterized compensation that must be included in their gross income.

Mischaracterized Distributions of Business Profits

In the second example, a group of members of an Indian tribe owns an information technology corporation that provides call center services. The corporation's headquarters are located on land held in trust by the Secretary of the Interior for the benefit of the tribe, and the tribe charges the corporation fair market value rent for use of the land. However, the lease agreement includes a provision whereby the corporation deposits an amount approximating its net revenues into the tribe's trust account, characterizing the revenue as additional rent. Subsequently, the tribe makes per capita distributions out of the trust account in an amount equal to the purported "additional rent" to the group of the tribe's members who own the corporation. The Notice states that the distributions are mischaracterized business profits that constitute gross income to the members.

Mischaracterized Gaming Revenues

In the third example, a corporation wholly owned by an Indian tribe owns and operates a casino located on land held in trust by the Secretary of the Interior for the benefit of the tribe. All of the corporation's gaming revenues are subject to the Indian Gaming Regulatory Act. Under a lease agreement with the tribe, the corporation deposits 50 percent of its net gaming revenues into the tribe's trust account, characterizing the deposits as rent for use of the land for the casino. Subsequently, the tribe authorizes per capita distributions to members of the tribe out of the net gaming revenues held in the trust account. The Notice states that the distributions are mischaracterized gaming revenues and constitute gross income to the members.

Footnote

1. In the Notice, the IRS explains that Congress intended that per capita distributions of tribal trust revenue "be subject to the provisions of [25 U.S.C. 1407, i.e., the Tribal Judgment Funds Act] with respect to tax exemptions" when it enacted the Per Capita Act in 1983 (citing H.R. Rep. No. 98-230 at 3), but that it did not intend to extend tax exemption to per capita distributions of gaming revenue (as evidenced by subsequently enacted statutory provisions that subject such distributions to reporting and withholding of tax).