RABBI TRUSTS FOR INDIAN CHILDREN: THE STORY OF A REVENUE PROCEDURE

By Joel S. Newman

Introduction

Young Bart (played by Cleavon Little) and his family were headed west in their Conestoga wagon when they were ambushed by the “entire Sioux nation.”1 Slowly, with dignity, the Indian chief (Mel Brooks) rode his horse closer to have a look at his new captives. “Let them go,” he said. Then he had some more things to say. Being Mel Brooks, however, he said them in Yiddish — his character was apparently a very rare Jewish Indian.2 Until I wrote this article, that episode from Blazing Saddles was the only interface I knew between Indians and Jews.3 Now I have another one, in a manner of speaking.

Here’s the story in a nutshell. The Indian tribes went into casino gambling operations in a big way. Inspired in part by federal regulation, many of them set up rabbi trusts to distribute gaming revenues to their children. After a series of technical advice memorandums and private letter rulings on the trusts, the IRS promulgated a safe harbor revenue procedure. Unfortunately, internal IRS disputes forced some compromises in the drafting. As a result, the weakened safe harbor is a step backward, at least for now.

It started in the United States Supreme Court. The states thought that they could prohibit, or at least regulate, gambling on Indian reservations within their territories. The Supreme Court said that, essentially, they could not.4 As a result, Indian tribes jumped in with both feet. Some of the early numbers were quite dramatic. The Mashantucket Pequot tribe’s casino in Connecticut grossed $750 million in its first year of operation.5 Further, soon after various tribes opened casinos in Minnesota, Wisconsin, and South Dakota, the Federal Reserve Bank of Minneapolis ran short of quarters.6 Of the 562 federally recognized Indian tribes, 224 engage in Class II or Class III gaming, with 354 gaming operations in 28 states.7 Indian gaming revenue has grown from $500 million in 1988 to more than $19 billion in 2004.8

Footnotes:

1Blazing Saddles (Warner Brothers 1974).
2Id.
3Personally, I’m not buying this 10 lost tribes stuff.
Casino gambling has had a major effect, both economically and socially, on the reservations. However, the impact has by no means been equally distributed. Some casino operations are huge, and some are comparatively tiny. In 2002, 41 Indian gaming operations each generated more than $100 million in annual revenues, accounting in the aggregate for 65 percent of the revenues generated by all Indian casinos that year. In contrast, 90 Indian gaming operations each generated less than $3 million in annual revenues, accounting for less than 1 percent of the revenues generated by all Indian casinos that year.\

Generally speaking, casinos at Indian reservations that are near large metropolitan areas tend to be big and successful while those that are not tend to be much smaller. The tribes that are most likely to be of interest to tax lawyers are very small tribes near very large cities. Those are likely to have large per capita payouts. Given that many tribes end up using the same lawyers, it should be no surprise that there are only a handful of private practitioners with expertise on the tax issues associated with Indian gaming — perhaps fewer than 10. It is that handful of lawyers who were involved with the events described below.

The Supreme Court may have restricted the ability of the states to regulate casino gambling on the reservations, but it did not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.

If those per capita trusts could be rabbi trusts, the tribes and their members would get their wish. Rabbi trusts, so named because the very first beneficiary was a rabbi, are designed to defer taxation of income to highly compensated executives. First, they are grantor trusts. Therefore, trust income is taxable to the grantors — not to the beneficiaries but it does not restrict the federal government. Left to itself, with the sole authority to regulate, Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988. Under IGRA, gaming revenues must be expended for the welfare of the tribe. One of the accepted ways to do that is to set up per capita trusts to share the revenues with tribal members — sometimes all of them and sometimes just the children. In fact, a quarter of the tribes that run casino gambling operations have per capita trusts. The specific requirements of those trusts are set forth in IGRA. One of the requirements is that the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved. That requirement has led to some controversy, as will be seen below.

IGRA provides that the payments from those per capita trusts will be taxable to the beneficiaries. However, it does not specify whether anyone else, or any other entity, should be taxable, nor does it tell us when those payments are to be taxable. Clearly, the best result for the tribes would be that the payments are taxable only to the beneficiaries and not until they are actually received.
the trusts or the beneficiaries. Second, the rights of the beneficiaries to the income are subject to contingencies. Thus, neither the constructive receipt doctrine nor the economic benefit doctrine applies, and the income is taxable to the beneficiaries only when actually distributed to them.

In the IGRA per capita trust context, grantor trust status is ideal. The grantor is the Indian tribe, which, by happy coincidence, is tax-exempt. Further, if the taxation of the beneficiaries can be deferred until actual distribution, then, in most cases, it will be deferred until they reach adulthood.

How do you know when you have a valid rabbi trust? In the area of executive compensation, it’s easy. Just follow the template in Rev. Proc. 92-64, the safe harbor model rabbi trust document. Note especially section 3(b) of the model trust:

At all times during the continuance of this Trust the principal and income of the Trust shall be subject to claims of general creditors of Company under federal and state law.

If trust assets are subject to the claims of general creditors, of course, the beneficiaries’ rights are not absolute, and the economic benefit doctrine cannot apply.

Would it be that easy for the Indian tribes? Could they simply follow the rabbi trust template? Maybe. But if the trust document provided that the tribe’s general creditors could get at trust assets, weren’t they violating IGRA, which required that the interests of the minors and other trust beneficiaries be protected and preserved? For a while, no one knew.

The issue was first addressed at the local IRS offices. They didn’t know what to do, so they requested help, in the form of TAMs. In other instances, it was the taxpayers who were requesting guidance, in the form of private letter rulings. There were a number of those rulings. I found 10 — 5 TAMs and 5 letter rulings. All involved per capita trusts. Three dealt with only adult beneficiaries; the rest dealt with minors or adults. Four were unfavorable to the tribes; the rest were favorable. After all of those rulings, the IRS promulgated Rev. Proc. 2003-14, 2003-1 C.B. 319, Doc 2003-545, 2003 TNT 4-16, which was meant to solve the problem and stop the parade of individual rulings. It certainly stopped the individual rulings, but it did not solve the problem. The rest of this piece will describe how, and why.

The Rules

The first two rulings, both in 1997, were TAMs. The first involved adult beneficiaries. The tribe argued that the income was exempt from the outset under the general welfare doctrine. That argument failed, at least in part because “the Tribe made equal payments of gaming revenues to all tribal members, regardless of their personal situations.”

The second involved minor beneficiaries. That one at least recognized the grantor trust. However, it concluded that the beneficiaries were taxable as soon as the money was deposited in the trust. The tribe had pointed out that the trust was revocable at any time. However, the IRS countered that, even if the trust were revoked, the tribe would still have been required to hold the assets for the benefit of the minor beneficiaries under IGRA. Therefore, under the economic benefit doctrine, the minor beneficiaries were taxable immediately.

Next was LTR 199906015. That ruling was bizarre in a few respects. First, it found a grantor trust, but concluded that the grantor was the beneficiary, not the tribe. Having made that finding, it did not even address any timing issues.

Second, it was a private letter ruling, not a TAM. One might expect to see a TAM adverse to the taxpayer because, typically, TAMs are initiated by the IRS. A private letter ruling, however, is initiated by the taxpayer. When the IRS plans to rule adversely on a private letter ruling, it must notify the requesting party and offer it the opportunity to withdraw the ruling request. Given that

22The most important case on economic benefit is Spraul v. Commissioner, 16 T.C. 244 (1951), aff’d per curiam, 194 F.2d 541 (6th Cir. 1952).
23Most of the trusts involved in the rulings addressed in this piece were confirmed by the IRS to be grantor trusts, under the following Internal Revenue Code sections:


Section 676: TAM 200229015, Doc 2002-5113, 2002 TNT 42-33. In TAMs 9717007, Doc 97-11607, 97 TNT 81-9, 200031006, Doc 2000-20696, and 200106007, Doc 2001-3987, 2001 TNT 29-10, the issue of grantor trust status was not addressed.

25Id.
26Remember IGRA section 2710(b)(3)(C). Also, there could be sovereignty concerns.
27TAMs still exist. In fact, Rev. Proc. 2005-2, 2005-1 IRB 86, Doc 2005-235, 2005 TNT 2-9, tells you exactly how to get one. However, they are used far less frequently today than they were even a few years ago due to the emergence of newer forms of chief counsel advice. See the tables in Judy Parvez and Sheryl Stratton, “IRS Guidance 1980-2003: An Ever-Changing Landscape,” Tax Notes, Nov. 15, 2004, p. 985.
opportunity, it is hard to imagine why a taxpayer would ever allow an adverse ruling to be published.\textsuperscript{36} If you want your trust to be a rabbi trust and the IRS has promulgated a safe harbor model, why not use it? Those early rulings didn’t, but the tribe requesting LTR 199908006\textsuperscript{37} did. Indeed, in the statement of facts submitted along with its formal request, it said as much:

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.\textsuperscript{38}

There were problems, however. First, Rev. Proc. 92-64 was intended to apply to the deferred compensation arrangements of highly paid employees. It doesn’t say anything about Indian tribes.\textsuperscript{39} Could the safe harbor be applied to those per capita trusts anyway? IRS internal documents noted that “XLC indicated concern about expanding rabbi trust rationale outside compensation context,”\textsuperscript{40} and further, that an IRS official “will have to check with his supervisors and get back to us on whether a rabbi trust should be allowed for a noncompensation situation.”\textsuperscript{41} Second, was the “subject to claims of creditors” language in the trust document consistent with IGRA’s requirement that the interests of the minors be protected and preserved?\textsuperscript{42} Internally, in many of those rulings deliberations, the IRS was concerned about that issue as well.\textsuperscript{43} Apparently, the IRS decided to apply the safe harbor anyway. It concluded in LTR 199908006:

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 or 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.\textsuperscript{44}

That result was also followed in TAM 200222003,\textsuperscript{45} in which the trust assets were again subject to the general claims of creditors.

So far, so good. But there is that nagging problem that subjecting trust assets to the claims of general creditors might be a violation of IGRA. Further, it tends to impugn the sovereignty of the tribe.

What if the provisions of the per capita trust were less restrictive than those of the safe harbor? Could it still be a rabbi trust? Yes, said the IRS. In each of four subsequent rulings,\textsuperscript{46} the trust assets were not subject to the claims of general creditors. Instead, there were other restrictions on the rights and immediate access of the beneficiaries. All of those rulings concluded that the various restrictions, even without the access of general creditors to trust funds, were sufficient to defeat the economic benefit rule.

Let’s take a brief digression and talk about the rulings process, generally. Private letter rulings are handled by the associate chief counsel’s office. Ruling requests are directed to different branches, depending on the issues presented.\textsuperscript{47} If multiple issues are presented, one branch will take primary responsibility, but it will consult with others. Of the five private letter rulings involved here, four of them were handled by associate chief counsel (passthroughs and special industries), which deals with grantor trust issues, and one\textsuperscript{48} was handled by associate chief counsel (income tax and accounting, or IT&A), which deals with timing issues.

Typically, letter rulings are not handed down from on high. Rather, they are negotiated. Well before a formal ruling request is filed, there are informal contacts between the taxpayer and the IRS. Those contacts take place...


\textsuperscript{37}LTR 199908006, supra note 23.

\textsuperscript{38}Id.

\textsuperscript{39}A private letter ruling on a nonqualified deferred compensation arrangement using a grantor trust subject to the claims of the employer’s creditors will be issued only if the trust conforms to the model language.” Rev. Proc. 92-64, supra note 24 (emphasis added).

\textsuperscript{40}Technical Case History to Letter Ruling 199908006, Form M-4114, October 1996, obtained under a FOIA request dated Nov. 9, 2004, for all background file documents relating to the 10 rulings (FOIA request).


\textsuperscript{42}IGRA section 2710(b)(3)(C).

\textsuperscript{43}In the Appeals Statement of Facts, Issues and Law and Analysis (TAM 200106007 FOIA request), the writer expresses concern that the various restrictions on the minor beneficiaries would violate IGRA. Yet, the writer notes, the trust had already been approved by the Department of the Interior. In the case history of Form 9718 (LTR 200222003 FOIA request), it is noted that Hines (passthroughs and special industries) “agreed that trust provisions making asset subject to claims of creditors appears inconsistent with IGRA.” Hines instructed the writer to confer with others within the IRS and coordinate their position before talking with the taxpayer’s counsel.

\textsuperscript{44}LTR 199908006, supra note 23.

\textsuperscript{45}TAM 200222003, supra note 23. The trust agreement had the general creditors language, although the plan did not. The plan and amended plan had been approved by the Bureau of Indian Affairs area director, but it wasn’t clear whether the trust agreement had been reviewed by either the area director or the National Indian Gaming Commission. The TAM analysis “assumes that all provisions of the Trust Agreement are valid and are not inconsistent with any provisions of IGRA [including the protected and preserved language].” Id. at n.5.

\textsuperscript{46}LTR 200022018, supra note 23, LTR 200022048, supra note 23, TAM 200106007, supra note 23, and LTR 200209015, supra note 23. As to TAM 200106007, the Washington office of Greenberg Traurig sent a “GT Alert” to its clients about it in March 2001.

\textsuperscript{47}Rev. Proc. 2005-1, supra note 35, sections 3.03, 3.05. LTRs designate their author within the IRS and the branch of Associate Chief Counsel with which the author is associated. TAMs have no such designation. However, armed with FOIA documents, it is sometimes possible to make a pretty good guess.

\textsuperscript{48}LTR 200022018, supra note 23.
by mail, telephone, and at face-to-face meetings.59 There are plenty of opportunities to sound out the other party. The taxpayer might ask the IRS informally how it would react to a given fact pattern. If the IRS reacts negatively, the taxpayer can tweak the hypothetical facts a little bit and try again.59 If the IRS is still negative, the taxpayer tweaks the facts a bit more, and so on, until both sides are satisfied. As mentioned earlier, if the IRS truly intends to promulgate an adverse ruling, it must notify the requester in advance. Typically, it offers not only the opportunity to withdraw but also the opportunity for a further conference and an attempt to work things out.

LTR 200022018 is of particular interest because I was able to talk to the lawyer and tribe who requested it.51 The Prairie Island Mdewakanton Dakota Reservation was recognized by the federal government in 1936.52 It opened a one-room bingo operation in 1984. In 1990, after Cabazon and IGRA, it added 250 slot machines and 8 blackjack tables. Now, having renamed their operation Treasure Island Resort & Casino, they have added 200 more slot machines, a 250-room hotel, a 137-slip marina on Sturgeon Lake, an RV park, a 120-passenger cruise yacht, and a nearby golf course. The front entrance to the casino is graced by a 40-foot waterfall.53 The property is located less than an hour’s drive from Minneapolis and St. Paul. Free bus service is provided from the Twin Cities and other locations.54 Afterward, if there’s anything left, the Mall of America is not far.

The Prairie Island Community set up a per capita trust in 1994.55 Under the master trust agreement, payments could be made to beneficiaries during their minority only at the trustee’s discretion, and, even then, only for certain stated purposes.56 Payments were to be made to beneficiaries who reached the age of 18 in accordance with a set schedule of ages and percentages.57 If the beneficiary died before reaching the age of 18, that person’s separate share would be paid in accordance with the written direction of the deceased beneficiary’s parent(s), provided that the parent was a member of the tribe.58 There was a spendthrift clause that provided, “No title in any share created hereunder or in the income therefrom shall vest in any beneficiary, and neither the principal of nor the income from any such share shall be liable for the debts of any beneficiary.”59 There was no language about access of general creditors.

The local IRS office was “on their backs.”60 Confronted with a live issue, the tribe decided to seek a private letter ruling. Its representatives had telephone conversations with Christie Jacobs, then of the associate chief counsel’s office (I&TA) on May 29, 1998, and July 6, 1998, and wrote her a letter on July 10, 1998.61

No tweaking of the facts was possible because the trust was already in place. Accordingly, the tribe’s counsel provided memoranda of law, highlighting the trust provisions mentioned above and explaining why those provisions made the application of either constructive receipt or economic benefit impossible.62 There was a presubmission conference on October 2, followed by a formal ruling request dated December 16, 1998. The final ruling was released in 2000. In that final letter ruling, the IRS agreed with the tribe, noting that, because of “various restrictions and conditions that must be satisfied

59 Id. at section 2.3.
60 Id. at section 2.4.
61 Id. at section 2.9.
62 Telephone interview with James Schoessler, supra note 51. Schoessler obtained the letter ruling on behalf of the tribe.
63 In the July 10 letter, the tribe’s counsel wrote: A recent IRS letter ruling and informal discussions with the ___ District Office have made us concerned that the IRS may attempt to tax the individual minor beneficiaries on an annual basis for the ___ contributions to the trust (and earnings thereon), regardless of whether there are actual distributions, and notwithstanding the language and intent of the designers of the trust. This is a serious issue. There are currently over 200 individual minors or incompetent persons in the trust program. These individuals generally do not have independent sources of annual income and must depend on a parent or guardian to file any returns and pay any taxes they may owe.

64 On the December 16, 1998, formal ruling request, someone, presumably at the IRS, entered a handwritten comment, “not persuasive,” next to the paragraph describing why section 2.4 of the Master Trust Agreement (dealing with the distribution of funds in the event that the minor beneficiary died) defeated the economic benefit rule. Apparently, whoever wrote that comment was overruled or the IRS consensus was that other trust provisions were more persuasive. LTR 200022018 FOIA Request. Counsel did not consult with other tribes or their lawyers as he went through this process, although he was generally aware that the Shakopee Mdewakanton Sioux Tribe was obtaining a private letter ruling at about the same time. Telephone interview with James Schoessler, Oct. 3, 2005.
before proceeds will be distributed to beneficiaries,” there was no economic benefit.63

With the appearance of LTR 200022018 and its three siblings, IT&A had a problem. True, LTRs are not precedent.64 However, they do indicate the IRS’s general direction. Further, they are at least embarrassing when the IRS takes a subsequent position that is inconsistent. The IRS had determined that rabbi trusts could be applied to the IGRA situation. But what about the reverse? Could those four rulings about IGRA trusts be applied to the deferred compensation trusts? If so, those rulings, with their liberal view of how little it took to defeat economic benefit, could open a window for the deferred compensation people and make life miserable for IT&A.

Rev. Proc. 2003-14

Meanwhile, Christie Jacobs was thinking about a more general revenue ruling.65 It takes time to obtain a private letter ruling, anywhere from six months to a few years. Moreover, it costs money, from $3,650 in 200666 to $7,000 now.67 Finally, it uses up limited IRS resources, taking time away from other projects. Jacobs reasoned that a general revenue ruling on IGRA trusts would save both the tribes and the IRS time and money.

She broached the subject with Nancy Marks of Tax Exempt and Government Entities and Linda Kroening of IT&A. Kroening suggested that they instead promulgate a safe harbor revenue procedure along the lines of Rev. Proc. 92-64 for rabbi trusts.68 The initial thought was to address the economic benefit problem by setting forth a smorgasbord of possible restrictions on the beneficiaries’ access to the funds, ranging from the Rev. Proc. 92-64 “subject to the claims of general creditors” language to the less draconian conditions that had sufficed in LTR 200022018. Presumably, any one selection from the menu would have done the trick.69

Jacobs soon discovered that not everyone at the IRS was as enthusiastic about a safe harbor as she was. IT&A was not willing to give any further IRS imprimatur to the more expansive rulings fearing their effect on the deferred compensation area. Therefore, the smorgasbord approach was out; it would have to be “subject to the claims of general creditors” or nothing. Further, it should be drafted by IT&A, not Passthrough and Special Industries.70

On the theory that it was better to have a weakened safe harbor than none at all, the IRS issued Rev. Proc. 2003-14. It contained the following requirement:

(8) The governing instrument provides that —

(b) Beneficiaries shall have no preferred claim on, or any beneficial ownership interest in, any assets of the trust; any rights created under the trust instrument shall be mere unsecured contractual rights of beneficiaries against the Indian tribe; and at all times during the continuance of the trust, the principal and income of the trust shall be subject to claims of general creditors of the Indian tribe under applicable federal, state, local, and tribal law.

The Rev. Proc. also requested comments: The Service requests comments on this revenue procedure and on the application of the economic benefit doctrine to IGRA trusts that are not within the scope of this revenue procedure. Specifically, the Service requests comments concerning the type of trust provisions that preclude the application of the economic benefit doctrine.71

Finally, it provided that no rulings or determination letters would be issued as to IGRA trusts that did not meet the requirements of Rev. Proc. 2003-14 until the IRS resolved the issue through publication of a revenue ruling, revenue procedure, or otherwise.72

The Aftermath

Comments did arrive. Many complimented the IRS on its attempt to create a safe harbor.73 Most, however, went

65LTR 200022018, supra note 23.
66Section 6101(k)(3).
67Interview with Christie Jacobs, May 20, 2005.
68LTR 200022018 FOIA Request.
69Rev. Proc. 2003-1, supra note 35, section 15 and Appendix A.
70The entire process was complicated by the Internal Revenue Service Restructuring and Reform Act of 1998, 112 Stat. 685, both for the revenue procedure and for Jacobs. She was heavily involved with the restructuring. Furthermore, in early 2000, she was appointed the first director of the new IRS Office of Indian Tribal Governments (ITG). In effect, she transitioned from IRS lawyer to IRS client.
72Id. at section 6. There is also a list of FAQs regarding IGRA trusts for minors at http://www.irs.gov/govt/tribes/article/0,,id=96135,00.html.
73Letter from James Schoessler, Apr. 24, 2003, Doc 2003-12067, 2003 TNT 103-18 (Schoessler letter); Letter from Craig J. Dorsay of Portland, Ore., on behalf of the Confederated Tribes of Siletz Indians of Oregon, May 2, 2003, Doc 2003-12068, 2003 TNT 103-23 (Dorsay letter); Letter from Mary J. Streitz, on behalf of the Confederated Tribes of the Siletz Indians of Oregon, May 2, 2003, Doc 2003-12069, 2003 TNT 103-20 (Streitz letter). Ms. Streitz called the safe harbor a welcome development, because tribal governments able to satisfy the safe harbor will no longer need to undertake the expense of an often lengthy private letter ruling process or face the prospect of costly and cumbersome audits or litigation regarding the federal income tax consequences of these vital tribal programs. Likewise, for those cases in which the safe harbor is satisfied, the IRS will be able to redirect its limited resources to achieve other important priorities.
on to criticize the ruling for its unnecessarily restrictive requirement as to the access of general creditors, one that might even impugn the sovereignty of the tribes. Moreover, some commented that the general creditors provision might be in violation of IGRA provisions that specified how the revenues were to be used.

However, some did indeed give the more specific guidance that the IRS had hoped for. Two cited the common provisions on the premature death of the minor beneficiary, arguing that those provisions would be sufficient to defeat the economic benefit doctrine. One suggested that a standard spendthrift trust position should be sufficient. Some even recommended specific trust indenture language.

Thus, the IRS got what it hoped for — careful, detailed comments, with many good suggestions on ways to liberalize the ruling in ways that might have been palatable to the deferred comp people at IT&A. And what has the IRS done? Nothing. There has been no revision, no finalization of Rev. Proc. 2003-14. In fact, since it is not on the IRS business plan, it does not seem likely that there will be progress any time soon. This state of affairs is all the more puzzling, since, with the enactment of new section 409A in 2004, one would have thought that the deferred compensation people at IRS would have had fewer concerns about rabbi trusts in general.

Michael Montemurro has an explanation. As senior technical reviewer at IT&A, he supervised the writing of Rev. Proc. 2003-14. He took the unusual step of soliciting comments, with the hope that the tribes would suggest some creative ways to achieve their objectives and yet not overly concern the deferred comp folks. Of course, once it solicited comments, the IRS was not about to issue more LTRs until the matter was resolved.

Now, unfortunately, the higher-ups at the IRS have put the entire project on the back burner. Thus, Montemurro and the tribes are in the frustrating limbo of no finalized safe harbor and no rulings. However, Montemurro is hopeful that some progress will be made despite the project’s low priority under the business plan.

In the words of one practitioner, ‘What good is a safe harbor when you shut down the port to future boats?’

That’s Montemurro’s story. Some, however, think that he is being a bit disingenuous. Robert Yoder, a Phoenix lawyer who represents about 30 tribes, says that the IRS has consistently resisted any meaningful consultation with the tribes for years. The request for comments in the revenue procedure, he says, was designed to create the illusion of consultation in light of Executive Order 13175, which requires all federal agencies to consult with the tribes. However, the IRS, he says, has not consulted with the tribes in the area of tribal pension funds or tax-exempt bonds, and has no real intention of consulting with them on IGRA trusts either. According to Yoder, a no-rule policy with a restrictive revenue requirement as to the access of general creditors would serve no one, whether or not they are deferred compensation people at IRS would have had fewer concerns about rabbi trusts in general.

Michael Montemurro has an explanation. As senior technical reviewer at IT&A, he supervised the writing of Rev. Proc. 2003-14. He took the unusual step of soliciting comments, with the hope that the tribes would suggest some creative ways to achieve their objectives and yet not overly concern the deferred comp folks. Of course, once it solicited comments, the IRS was not about to issue more LTRs until the matter was resolved. Now, unfortunately, the higher-ups at the IRS have put the entire project on the back burner. Thus, Montemurro and the tribes are in the frustrating limbo of no finalized safe harbor and no rulings. However, Montemurro is hopeful that some progress will be made despite the project’s low priority under the business plan.

In the words of one practitioner, ‘What good is a safe harbor when you shut down the port to future boats?’

That’s Montemurro’s story. Some, however, think that he is being a bit disingenuous. Robert Yoder, a Phoenix lawyer who represents about 30 tribes, says that the IRS has consistently resisted any meaningful consultation with the tribes for years. The request for comments in the revenue procedure, he says, was designed to create the illusion of consultation in light of Executive Order 13175, which requires all federal agencies to consult with the tribes. However, the IRS, he says, has not consulted with the tribes in the area of tribal pension funds or tax-exempt bonds, and has no real intention of consulting with them on IGRA trusts either. According to Yoder, a no-rule policy with a restrictive revenue requirement as to the access of general creditors would serve no one, whether or not they are deferred compensation people at IRS would have had fewer concerns about rabbi trusts in general.
procedure is exactly what the IRS wants — no meaningful consultation and no meaningful guidance. I have described the chasm between Montemurro’s view and Yoder’s view to some other players in the area; most believe that the truth lies in the middle.

So, the revenue procedure, probably initiated in good faith, has in fact been a step backward. Post-2003, the tribes have generally not used it as a safe harbor. Further, without following the revenue procedure to the letter, and with the no-rule policy in place, no one can have complete confidence about the tax consequences of post-2003 IGRA trusts.

So, what are we to make of the continuing impasse? Is it, as Montemurro suggests, a frustrating result of an IRS that simply has too many projects on its plate? Is it, as Yoder suggests, a cynical plan by the IRS to give the tribes no consultation and no guidance, while pretending to do the opposite? Then again, perhaps it is part of a broader picture. For years, the IRS has been less and less enthusiastic about giving any guidance at all, about anything. So why should it treat Indian tribes any differently from anyone else?

What’s the answer? As Chief Mel Brooks would say, Wer viest? (Who knows?)

88I have absolutely no idea what effect, if any, the lobbying scandals have had on these issues. See Michael Janofsky, “Senate Opens Hearings on Lobbyists for Tribes,” The New York Times, Sept. 30, 2004, at A23.

89Was moving the ITG away from the main IRS building on Constitution Ave. mere happenstance, or is it a symbolic indication of ugly stepsister status? In any event, it is no longer possible for ITG staffers to simply walk down the hall when they want to confer with the most important IRS officials.

90See the tables in Parvez and Stratton, supra note 27. Sheldon Cohen, former IRS commissioner, confirms that the amount of published guidance has diminished dramatically since he was commissioner. He cites two reasons. First, published guidance costs money, and the IRS doesn’t have very much. Second, since FOIA, the IRS is reluctant to give out no-longer-private letter ruling advice, fearing it might be publicly wrong. Telephone interview with Sheldon Cohen, Nov. 15, 2005.