

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-107878-99/CC:DOM:IT&A:B3

District Director:

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Tribe	=
Tax Year	=
Law	=
X	=

ISSUE:

Whether benefits provided to tribal members through various programs administered by the education department of the tribal government of Tribe are taxable to the recipients and subject to income tax withholding under section 3402(r) of the Internal Revenue Code?

CONCLUSION:

Benefits provided to tribal members through various programs administered by the education department of the tribal government of Tribe are not per capita payments and are not subject to income tax withholding under section 3402(r) of the Code.

FACTS:

Tribe is a federally recognized Indian tribe under Law. The members of Tribe are governed by an elected tribal council. Election terms, responsibilities, and duties of the tribal council are set forth in the Tribe's constitution and by-laws, which can be amended only by a two-thirds vote of eligible voters. In the tax year at issue, the Tribe had approximately X enrolled members.

Tribe operates various commercial enterprises, including a casino. Tribe conducts both class II and class III gaming operations pursuant to the Indian Gaming Regulatory Act, 25 U.S.C. 2701 et seq. (1988) (IGRA). Generally, income from the casino is the primary source of funding for Tribe's government.

Tribe provides basic government services consistent with those provided by state and local governments. Those services include education, public safety (including police and fire protection), tribal court system, social services, public works, health services, housing authority, parks and recreation, cultural resources, and a museum.

Tribe's education department provides essential educational and developmental services to its members through multiple educational programs. These programs are designed by Tribe to meet the varying educational needs of the members and are administered without regard to the financial needs of the student. Tribe received several federal grants that covered a portion of the costs of the programs at issue. The relevant programs administered by Tribe's education department are:

Child Development Center—Tribe's child development center provides age-appropriate education for tribal children from infancy through kindergarten. The infant/toddler program is centered on sensorial experiences, and the environment is structured to provide a variety of motor and sensory experiences. The pre-kindergarten and kindergarten programs integrate cognitive, physical, and affective development. These programs provide math, language, science, and social studies, along with media, to build visual, auditory, and motor skills and to develop memory. The center also provides programs for special needs children within its existing programs. After completing kindergarten, most tribal children enter public elementary schools in the surrounding communities. Some children are enrolled at the center by order of the Tribe's child protective service.

Temporary Educational Instructors—Tutoring programs are available to tribal youth and adult members to provide remedial instruction. These programs were developed due to the large number of tribal members who had not completed their formal education. Tutoring and adult education are available to help members obtain a high school general equivalency degree (GED), college preparatory assistance, after-school tutoring, and life skills classes.

Summer Youth Program—Tribe maintains a program for tribal children which began as a safe house with 24-hour supervision for children ages 5 to 12 who are in need of care or who have been removed from their homes for their protection. As part of that program, some children are taken to the mountains during the summer. Many of the children in the program formerly resided in an inner-city environment. The program provides a stable environment, recreational activities, and the opportunity for the individual child to develop a sense of self-worth, respect for others, and leadership skills. The summer program was within the scope of a Johnson-O'Malley Grant administered by the Bureau of Indian Affairs, 25 U.S.C. §§ 452 et seq. (1934).

Room and Board at Residential Schools—During Tax Year, payments of room and board were made to two secondary schools on behalf of several tribal youths. The schools specialized in providing highly structured residential living for students with learning disabilities and other special needs.

Upon audit, the Revenue Agent took the position that the amounts paid by Tribe for the above programs were distributions of net revenues of class II or III gaming activities subject to withholding by Tribe in accordance with section 3402(r) of the Code.

LAW:

Section 2703 of IGRA classifies gaming activities conducted by Indian tribes. Class I gaming activities are social games solely for prizes of minimal value or traditional forms of Indian gaming engaged in as part of tribal ceremonies. Class II gaming activities generally are bingo, games similar to bingo (e.g., pull tabs, punch boards, tip jars, and instant bingo) and card games either (1) explicitly authorized by the State or (2) not explicitly prohibited by the State, played at any location in the State, and conducted in conformity with any State regulations regarding periods of operation or wagering limitations. Class II gaming activities do not include any banking card games (e.g., baccarat, chemin de fer, or blackjack), slot machines or any electronic or electromagnetic facsimiles of games of chance. Class III gaming activities are all forms of gaming that are not classified as class I or class II.

Section 2710(b)(2)(B) of IGRA provides a listing of authorized uses of the net revenues from class II and class III gaming activities conducted by Indian tribes: (i) to fund tribal government operations or programs; (ii) to provide for the general welfare of the Indian tribe and its members; (iii) to promote tribal economic development; (iv) to donate to charitable organizations; or (v) to help fund operations of local government agencies. Section 2710(d)(1).

Section 2710(b)(3) of IGRA provides that the net revenues from class II and class III gaming activities may be used to make per capita payments to members of the Indian tribe only if the Indian tribe has prepared a plan to allocate revenues to uses authorized by paragraph (2)(B). Section 2710(b)(3) also provides that per capita payments are subject to Federal taxation and the tribes must notify members of such tax liability when payments are made. Section 2710(d)(1).

Section 3402(r)(1) of the Internal Revenue Code provides—

Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

Section 3402(r) was added to the Internal Revenue Code by the Uruguay Round Agreements Act, Pub. L. No. 103-465, § 701 (1994). House of Representatives Report No. 826 Part 1, 103rd Cong., 2d Sess. (1994), 1995-1 C.B. 250, which accompanied the Act, states:

Present law

...

Net revenue from certain gaming activities conducted or licensed by an Indian tribe may be used to make taxable distributions to members of an Indian tribe. The tribe must notify its members of the tax liability at the time the payments are made. 25 U.S.C. 2710(b)(3) and 2710(d)(1). The tribe is not required to withhold on such payments except to the extent backup withholding rules apply under section 3406.

Reasons for change

Distributions of net revenues from gaming activity by an Indian tribe may result in significant tax liability to the tribe's members. Establishing withholding on such payments will more closely match estimated tax payments to ultimate tax liability. For some tribal members, this change may eliminate the need to make quarterly estimated tax payments. For others, it will reduce the likelihood that they will face penalties for underpayment of tax at the time of tax filing.

Section 7701(a)(40) of the Code provides:

The term "Indian tribal government" means the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary, after consultation with the Secretary of the Interior, to exercise governmental functions.

ANALYSIS:

Tribe's programs at issue, Child Development Center, Temporary Education Instructors, Summer Youth Program, and Room and Board at Residential Schools, are all administered by its education department and are part of the department's educational services to tribal members. The facts presented show that Tribe provides the programs to meet educational needs of tribal members. Nothing indicates that Tribe provides the programs to distribute net revenues from gaming to tribal members generally. Direct distributions are not made under these programs to tribal members. Nor are these educational benefits provided under a constructive distribution program, for example, where tribal members select benefits that Tribe pays for. Tribe's position is that its educational services, including the programs at issue, are basic governmental services and provide substantially similar benefits to those provided by federal, state, and local

government educational programs. After review of the facts with respect to these programs, we agree.

Section 7701(a)(40) of the Code defines Indian tribal governments as governing bodies of Indian tribes and recognizes that these bodies exercise governmental functions. In general, where Indian tribal governments act in this capacity to provide the types of benefits traditionally provided by a government to its citizens, for example, as in the present case, providing a full array of educational benefits to the children of the community, tax treatment should be analogous.

Section 2710(b) of IGRA lists authorized uses by Indian tribes of the net revenues from class II and class III gaming activities. Section 2710(b)(3) and section 2710(d)(1) of IGRA provide that net revenues from class II and class III gaming activities may be used to make per capita payments to members of the Indian tribe only if the tribe has prepared a plan to allocate revenues to uses authorized by section 2710(b)(2)(B), including funding tribal government operations or programs. Section 2710(b)(3) and section 2710(d)(1) state that per capita payments are subject to federal taxation and that the tribe must notify members of their tax liability for per capita payments when such payments are made. Section 3402(r) of the Internal Revenue Code requires the tribe to withhold income tax on such per capita payments. H.R. Rep. No. 826 Part 1, 103rd Cong., 2d Sess. (1994), 1995-1 C.B. 250.

These provisions, which are intended to ensure adequate withholding on taxable benefits arising from the distribution of net revenues from class II or class III gaming activities, are not intended to and do not operate to extend the scope of what is taxable. Thus, withholding under section 3402(r) is not imposed merely by reason of the benefits being sourced in class II or class III gaming activities but rather by reason of the benefits being taxable income in the form of a payment described in section 3402(r). Because the described benefits are neither, but are rather the type of benefit routinely provided by government entities and are being provided in the present case by the Indian tribal government in its governmental capacity, they do not result in income to the recipients or give rise to withholding under section 3402(r).

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.