

ALERT

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Does Your Tribe's Minors' Trust Need a Tune-Up?

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Many Indian tribes have established minors' trusts to hold gaming revenue distributions for their minor members (beneficiaries). Although minors' trusts have the potential to provide trust beneficiaries with the resources to meet educational and financial goals, they are often viewed by tribal leaders as a source of concern and difficulty. In practice, minors' trusts are frequently mismanaged by fiduciaries and beset by compliance failures. They also may contain distribution provisions that run counter to the goal of providing beneficiaries with long-term financial security.

This Alert focuses primarily on the income tax compliance requirements applicable to minors' trusts and discusses how these requirements can still be met without sacrificing educational goals and long-term financial security.

Background on Minors' Trusts

Indian tribes may distribute gaming revenues to tribal members if they comply with the Indian Gaming Regulatory Act (IGRA).

IGRA requires tribes to prepare a revenue allocation plan. *See* 25 U.S.C. §2710(b)(3)(A). The revenue allocation plan must provide that gaming revenues will be used only for certain purposes, including providing "for the general welfare of the Indian tribe and its members." *See* 25 U.S.C. §2710(b)(2)(B)(ii).

As part of providing for its members, tribes are required to ensure that "the interests of minors . . . who are entitled to receive any of the per capita payments are protected and preserved" and funds are available "in such amounts as may be necessary for the health, education, or welfare of the minor" *See* 25 U.S.C. §2710(b)(3)(C).

To comply with IGRA, Indian tribes often create a minors' trust that holds its minor members' distributions. Using a grantor trust allows beneficiaries to defer paying federal income taxes on their gaming distributions until such funds are paid out by the trust, assuming the trust meets certain requirements.

Revenue Procedure 2003-14

Revenue Procedure 2003-14 provides a safe harbor under which the beneficiaries will not be required to include gaming revenues in gross income when transferred to, or earned by, the trust. Rather, beneficiaries will be able to



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defer their income taxes on these amounts until actually or constructively received. The safe harbor requirements are as follows:

- The Indian tribe complies with the IGRA requirements relating to the disbursement of per capita payments to tribal members.
- All trust contributions are distributed in accordance with the tribe's plan to allocate gaming revenues, as required under IGRA.
- All trust beneficiaries are members of the tribe that establishes the trust.
- Each trust beneficiary is a minor or legal incompetent at the time the trust is established and all contributions are made to the trust with respect to such beneficiary.
- The trust complies with the applicable federal, state and tribal laws.
- The governing trust instrument states that the trust is intended to be a grantor trust and that the tribe is the grantor of the trust.
- The governing trust instrument grants the tribe a power or interest that causes it to be treated as the owner of the trust.

In addition, the governing trust instrument provides that:

- trust assets are not available to a beneficiary until he or she attains a specified age or ceases to be a legal incompetent, except for distributions for the health, education or welfare of the beneficiary made at the sole discretion of the trustee
- beneficiaries do not have any ownership or claim to the trust assets
- the trustee will cease payments to the beneficiaries and hold the assets of the trust for the benefit of the tribe's general creditors throughout any period in which the trustee believes or has reason to believe that the tribe is unable to pay its debts as they become due, or is subject to a pending insolvency or bankruptcy proceeding
- the beneficiary's share will be paid to the tribe if the beneficiary dies prior to attaining the specified age or legal competency, or alternatively, the beneficiary dies prior to attaining the specified age or legal competency without one or more of the following relatives surviving: a spouse, parent, child or sibling

Financial Considerations

Increasingly, Indian tribal leaders have observed that distributing a large lump sum to beneficiaries when they turn 18 years old often fails to provide long-term financial security, and can undermine educational goals. Too often, the funds are spent on items that quickly depreciate, or their receipt is perceived as negating the need for higher education. Tribes frequently seek legal guidance on amending their trusts to increase the beneficiaries' long-term financial security.

Legal Considerations

These concerns can often be relieved through a variety of mechanisms, but each one has to be carefully evaluated to make sure that the solution does not result in the trust losing its tax-deferred character. This is particularly important in view of the fact that minors with unearned income (such as the gaming distributions placed into a trust that is *not* tax-deferred) are subject to the Kiddie Tax at a rate equal to their parents' rate of tax. (See Holland & Knight's December 15, 2008 Alert, [Expanded Kiddie Tax Hits More Tribal Minors' Trust Distributions](#).)

For example, some tribes have moved away from distributing the entire trust corpus at age 18 and have set up a staggered trust distribution system in which beneficiaries receive portions of their trust funds over a period of time (starting at age 18). Although staggered distributions were not covered in Revenue Procedure 2003-14, the IRS has approved staggered distributions three times in years prior to 2003:

- In a private letter ruling issued on June 5, 2000, the IRS approved a minors' trust staggered distribution culminating when the beneficiary turned 35 years old.
- In a second private letter ruling issued on June 5, 2000, the IRS approved a minors' trust in which the beneficiaries received multiple payments in their twenties.
- In a technical advice memorandum issued on May 31, 2002, the IRS ruled favorably on a minors' trust agreement that provided for a series of payments culminating with the beneficiary's thirtieth birthday.

Tribes are free to craft their own staggered distribution provision that increases the likelihood of long-term financial security. For example, if a tribe wanted to promote education, a staggered distribution scheme could be set up that allows accelerated payments if the beneficiary completes certain educational milestones, such as obtaining a high school degree or G.E.D., obtaining a two-year degree, a four-year degree or completing a graduate program.

Other Possible Reasons for a Tune-Up

The following are other possible reasons for a minors' trust tune-up:

- to fine-tune the advance distribution provisions (*i.e.*, those provisions intended to make sure that minors' health, education and welfare needs are met prior to their receiving trust distributions)
- to ensure that the "kiddie tax," as it is commonly known, does not apply resulting in amounts being taxed at the parent's (often higher) marginal tax rate
- to provide incentives for certain behaviors, such as attending college or purchasing a home
- to prevent trust distributions from disqualifying Beneficiaries from obtaining student loans or various forms of government assistance (*e.g.*, Medicaid or disability assistance)
- to make sure that the roles and responsibilities of trustees, investment advisors and trust administrators are clearly spelled out in the trust agreement or other documentation

Conclusion

Tribal minors' trusts often do not function the way that that they were originally intended. In some cases, they contain provisions that actually run counter to the tribe's goals of meeting the health, education and welfare needs of the beneficiaries. In other cases, trusts can give rise to the kiddie tax, disqualify beneficiaries from student loans or fail to provide incentives that are important to the tribe. In other cases, tribes find that trustees or other fiduciaries are not managing the trust economically or responsively. All of these issues can be addressed by a review or "tune-up" of the tribe's minors' trust agreement.

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