Taxation on the Reservation—Post Script

By James M. Susa and Elise S. Pecchenino

James M. Susa and Elise S. Pecchenino provide an overview of the taxation of Native American tribes on reservation land.

Introduction

The Journal of State Taxation published an article titled *Taxation on Indian Reservations: To Balance or Not to Balance, That Is the Question* in the September–October 2013 edition. The article addressed what effect the recent U.S. Department of Interior regulations might have upon the existing law regarding state and local taxation of activities upon Indian reservations.[1] While the regulations ostensibly could be construed to create a "tax free zone" for activity, commentators noted that such an interpretation would be a significant departure from the existing federal case law. This existing federal framework requires a three-party balancing test to evaluate the validity of imposing certain state and local taxes upon activities.[2] After several years of litigation, the "tax free zone" concern is "much ado about nothing."[3]

Summary of Law Prior to 2013

Before 2013, courts applied two tests to determine the validity of a state or local tax placed upon the tribes, tribal members or business activities conducted upon the reservation by persons other than the tribes or tribal members. The first test, called the categorical approach, precludes the state and its political subdivisions from directly taxing tribes and tribal members for activities that take place upon the reservation.[4] The second test called the preemption doctrine balances federal, tribal and state interests to determine if the federal and/or tribal interests supersede the state's interest regarding the taxation.[5] The preemption doctrine

JAMES M. SUSA, Esq., is a Shareholder at DeConcini McDonald Yetwin & Lacy, P.C., Tucson, Arizona.

ELISE S. PECCHENINO, Esq., is a Tucson, Arizona attorney.

is often referred to as the *Bracker* balancing test after the first case that utilized it in 1980 to determine the validity of an Arizona tax imposed on reservation activity. Utilizing these two tests, courts adjudicated a number of cases which occasionally allowed for the imposition of taxes[6] and sometimes invalidated the tax.[7] In general, the United States was not a party to any of the lawsuits, though it sometimes filed an amicus brief which supported one side or the other in such litigation. Against this backdrop, the Department of the Interior issued regulations which created the belief that the United States was finally asserting its inherent authority under the Supremacy Clause[8] thereby settling the taxation issue in favor of no taxation upon the reservation.

When the regulations were enacted, tribes sought a judicial declaration that the regulations preempted all state and local taxation upon a reservation or upon Tribal property.

Courts View the Regulation as Merely Part of the Balancing Test

The Confederated Tribes of the Chehalis Reservation was likely the first to litigate the meaning and impact of the regulations. Thurston County in the State of Washington attempted to levy a tax upon permanent improvements built on non-reservation land. The Tribe had purchased land away from its reservation and requested the U.S. Department of Interior take title from the Tribe and hold the property in trust for the Tribe. The Department obliged the Tribe's request and thereafter a Tribal affiliated company initiated construction of a resort, conference center and water park on the non-reservation land. The County asserted that while the land was immune from local property taxation, the improvements enjoyed no such immunity from tax due to the improvements ownership by a Tribal affiliated entity, but not the Tribe itself.

The Court of Appeals held that a federal statute[9] invalidated the tax because the permanent improvements were affixed to the real property and the real property was owned by the United States. The Court deemed immaterial the fact that the Tribe or tribal entity did not own the improvements: the "form in which the Tribe chooses to conduct its business" is irrelevant to the fact the property is held for the benefit of the Tribe.[10] In a footnote, the Court also dispensed with the Tribe's argument that the regulations, standing alone, dictated the result it sought.[11]

After the *Confederated Tribes'* decision in 2013 avoided the question regarding the regulations' impact, the U.S. Court of Appeals for the Eleventh Circuit addressed the question directly two years later in *Seminole Tribe of Florida v. Stranburg*.[12] The case involved an attempt by the State of Florida to impose a rental tax upon the Tribe for activities at one of its casino properties located on the reservation.[13] In this case, the Tribe owned all the permanent improvements at issue. The Seminole Tribe asserted that the rental tax was invalid under the same federal statute applied in *Confederated Tribes* by the Ninth Circuit. The Eleventh Circuit agreed that the federal statute categorically barred the rental tax even though the rental tax was different in nature than the tax barred by the Ninth Circuit.[14]

After deciding that the statute alone barred the rental tax, the Eleventh Circuit went one step further. It reviewed the District Court's alternative basis for invalidating the rental tax. The District Court interpreted the regulations to mean that the *Bracker* balancing test resulted in federal and tribal interests outweighing the state interest. Based on the District Court's reasoning, the Secretary of the Interior deserved full deference for promulgating regulations governing the leasing of Indian land, including a regulation that prohibits the rental tax. This argument had been advanced by the Tribe.

In reviewing the District Court's decision, the Eleventh Circuit was not quite as generous. It concluded that the regulations were not entitled to any deference in conducting a *Bracker* balancing inquiry. However, it also concluded that the regulations were "not without value in delineating the federal and tribal interest implicated" in the lease of Indian land.[15] Thus, the Eleventh Circuit narrowed the use of the regulations. Instead of facilitating a federally mandated "tax free zone," the regulations now serve as evidence of the federal interest in the *Bracker* balancing inquiry for the purpose of invalidating a tax upon reservation property.

In 2017, federal courts in California decided two related cases. The first was *Desert Water Agency* decided by the U.S. Court of Appeals for the Ninth Circuit in March.[16] Desert Water Agency ("DWA") is a California political subdivision that supplies water and water services to businesses and residences in Riverside County. DWA brought suit in federal court to obtain a declaratory judgment. The water agency charged fees and taxes to deliver water upon the reservation and wanted to collect these amounts from various non-Indian lessees that had erected several permanent establishments within the reservation.[17] No person receiving water had refused to

pay the fees and taxes, but DWA sought a judicial ruling that potential refusals could not be based upon the regulations' enactment. The sole issue before the Ninth Circuit in this case was whether DWA had standing to assert the validity of the fees and taxes. Most significantly, this litigation did not involve the tribe upon whose reservation DWA delivered water. The Court compartmentalized the issue by addressing whether and to what extent the regulations would injure DWA.

DWA asserted that the regulations displaced the *Bracker* balancing test completely and barred DWA from assessing fees and taxes for water delivery. In a strange twist, this "displacement" argument was the same one raised by the tribes in *Confederated Tribes* and *Seminole Tribe* earlier in attempts to thwart state and local taxation. In this case, the water agency raised the argument to fulfill the court's standing requirement by showing actual harm to the taxing entity, DWA. The Department of the Interior countered that the regulations had no legal effect at all on the judge-made *Bracker* balancing test. Agreeing with the Eleventh Circuit, the Department of the Interior said the only relevancy of the regulations is to publically state the federal and tribal interests in any balancing test.

Because the Department of the Interior advocated that the regulations only formalize the federal and tribal interest in the *Bracker* balancing test, the Ninth Circuit concluded that the language in the regulations did not bar DWA's fees and taxes. As a result, DWA would not be harmed by the regulations' enactment and thus DWA had no standing to contest the regulation's validity as applied to its fees and taxes.

The second related case is *Agua Caliente Band of Cahuilla Indians v. Riverside County.*[18] The plaintiff is the Tribe upon whose reservation DWA delivers water. The Tribe sued the County seeking to invalidate the County's possessory interest tax. The tax is levied upon the value of the non-tribal person's interest in property owned by the Tribe or tribal member and leased to that non-tribal person.[19] The tax is based on 1% of the full cash value of the non-tribal person's interest under the lease agreement.

The Tribe asserted three reasons for invalidating the tax. First, the tax violated the same federal statute that was used to decide the *Confederated Tribes* litigation in 2013. Second, the *Bracker* balancing test weighed in favor of federal preemption. Third, the tax interferes with the Tribe's sovereignty. The Tribe lost on all three arguments. The regulations were discussed in the context of the second argument, the *Bracker* balancing test. The Court held the regulations were a part of the federal interest in the test, the same conclusion reached in *Seminole Tribe*, and that the regulations and statutes all support the Federal government's strong interest in preemption of state and local taxes in leasing situations.

Nevertheless, the Court considered the County's interest in collecting the tax as part of the balancing test. In that analysis, the Court discussed the relationship of the County tax and the services the tax funds upon the reservation. The Court noted that the County provides a majority of the public services rendered on the reservation from public road maintenance, animal and pest control to public safety, law enforcement and education. All of these County services are funded by taxes, including the possessory interest tax at issue in the litigation. The balancing test thus favored the County imposing the tax. This may not be the final conclusion on the case as the District Court's judgment has been appealed to the U.S. Court of Appeals for the Ninth Circuit.[20]

Unless the U.S. Court of Appeals for the Ninth Circuit ignores the Department's stance and sides with the Tribe in the Agua Caliente appeal, four years of attempts to decide the meaning of the regulations will end with little effect on the overall tax analysis.

Conclusion

When the regulations were enacted, tribes sought a judicial declaration that the regulations preempted all state and local taxation upon a reservation or upon Tribal property. A fatal blow to this argument occurred in *Desert Water Agency* when the Department of the Interior asserted that the regulations did not preempt taxation, but were merely part of the complex body of law surrounding the taxation of tribes, tribal members and activities occurring on tribal property. Unless the U.S. Court of Appeals for the Ninth Circuit ignores the Department's stance and sides with the Tribe in the *Agua Caliente* appeal, four years of attempts to decide the meaning of the regulations will end with little effect on the overall tax analysis. The courts will thus continue to use the categorical approach and preemption doctrine to test the validity of state and local taxes.

ENDNOTES

[1] 25 CFR §162.017.

[2] The test was first used by the court in *White Mountain Apache Tribe v. Bracker*, 148 U.S. 136, 100 S.Ct. 2578 (1980).

[3] Play by William Shakespeare of the same name first performed in 1612.

[4] *See Oklahoma Tax Commission v. Chickasaw Nation*, SCt, 515 US 450, 115 SCt 2214 (1995) as an example of the categorical approach.

[5] *See Ramah v. Navajo School Board*, SCt, 458 US 832, 102 SCt 3394 (1982) as an example of the preemption doctrine.

[6] *Arizona Department of Revenue v. Greenberg Construction*, 182 Ariz. 391 (App. 1995) (allowing state privilege tax assessment against contractor building school facilities upon reservation because contract for construction was with school district, not tribe). *Arizona Department of Revenue v. Blaze Construction Company*, SCt, 526 US 32, 119 SCt 957 (1999) (upholding state privilege tax assessment against contractor building roads upon reservation because contract was with federal government).

[7] *Eastern Navajo Industries, Inc. v. Bureau of Revenue,* 89 N.M. 369 (1976) (holding that tribal member majority ownership of construction company sufficient basis to apply categorical approach to invalidate privilege tax assessment).

[8] U.S. Constitution, Article VI, paragraph 2.

[9] 25 USC §465 states that lands taken into trust by the United States for the benefit of a tribe shall be "exempt from State and local taxation."

[10] *Confederated Tribes of the Chehalis Reservation v. Thurston County Board of Equalization*, CA-9, 724 F3d 1153, 1157 (2013).

[11] *Id.*, fn. 6. [B]ecause this regulation "merely clarifies and confirms" what Code Sec. 465 "already conveys," we need not reach the applicability of this regulation or the level of deference owed to the Bureau of Indian Affairs in this context.

[12] *Seminole Tribe of Florida v. Stranburg,* CA-11, 799 F3d 1324 (2015).

[13] The State of Florida also sought to impose a utility tax, which the Court upheld because the tax was upon the utility provider and not the customer.

[14] The Ninth Circuit decision in *Confederated* involved a local property tax assessed upon the value of the permanent improvements. In contrast, the Eleventh Circuit decision in *Seminole* involved two state excise taxes imposed upon the gross receipts from engaging in a particular business activity (renting real property and providing utility services).

[15] *Seminole* at 1338.

[16] *Desert Water Agency,* CA-9, 849 F3d 1250 (2017).

[17] The real property improvements were homes, hotels, restaurants and stores. The water charges were upon the lessees themselves, not the tribe or tribal members.

[18] U.S. District Court, Central District California, 2017 WL 4533698 (June 15, 2017).

[19] The Tribe's reservation is over 31,000 acres in a checkerboard pattern across Palm Springs, Cathedral City, and Rancho Mirage and extends to unincorporated areas outside those cities' limits. Some of the reservation land is owned by the United States and held in trust for the Tribe. The remainder is owned by the Tribe. This case deals only with the portion owned by the United States. There are approximately 20,000 master leases, subleases and sub-subleases for the use and occupancy of the land. Revenues derived from this leasing activity fund Tribal government.

[20] The Court has docketed the appeal as case number 17-56003. The notice of appeal is dated July 14, 2017, and briefing is currently under way.