

2016 Native American Tax Litigation Roundup

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One driver of economic development for many tribes is derived from their ability to impose taxes on business activities on reservations free from state and local taxation. This year, there has been continued litigation to determine the metes and bounds of federal preemption of state and local taxes on reservation business activity. Resolution of disputes arising from such taxes often requires courts to engage in particularized inquiries into the taxes, federal laws, regulations and the tribal, state and federal interests at issue in each case. This article identifies tax cases that tribal attorneys are following in 2016. These tax disputes raise important corollary issues, such as the proper interpretation of federal leasing regulations addressing taxation, the interpretation of arbitration clauses and the impact of an untimely collateral challenge to fee-to-trust conveyance on state tax authority



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Interpretation of federal leasing regulations addressing taxation

In January 2013, new federal leasing regulations providing that leasehold or possessory interests on leased Indian trust lands “are not subject to any tax or fee imposed by any State or political subdivision of the State” went into effect. 25 C.F.R. § 162.017(c). The impact of this regulation on state taxes on Indian reservations has been the subject of two cases involving the Agua Caliente Band of Cahuilla Indian Reservation.



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In one of the cases, Agua Caliente challenges the legality of a California state tax assessed by the county on possessory interests held by lessees of Indian trust land within the tribe’s reservation.[1] The tax is a general revenue tax, not directly tied to any services that the county provides to Indian landowners or their lessees. The tribe argues that the tax is preempted by federal law pursuant to a balancing of relevant federal, state and tribal interests under the Bracker balancing test, established by *White Mountain Apache v. Bracker* (Bracker), and points to the leasing regulation as indicative of the strong federal interest to be weighed.[2] Agua Caliente further relies upon 25 U.S.C. § 465, providing that Indian trust lands “shall be exempt from State and local taxation.”

In an opinion denying defendants’ motion for judgment on the pleadings, the court rejected defendants’ argument that the Bureau of Indian Affairs exceeded its authority in promulgating Section 162.017, finding instead that the regulation was entitled to deference. The court held that the regulation “clarif[ies] the very issue at hand” concerning federal interests considered in the Bracker balancing test and is “highly indicative of significant federal interest in promoting Indian self-determination and economic

development that would be thwarted” by the county’s tax.[3] Following the district court’s opinion in Agua Caliente, and consistent with that ruling, the United States filed an amicus brief asserting that Section 162.017(c) does not itself preempt state and local taxes, but rather is indicative of the strong federal interest to be weighed as part of the Bracker preemption analysis.

Desert Water Agency (DWA), a water agency that services Agua Caliente’s reservation, also brought a suit against the United States arguing that 162.017(c) does not preempt DWA’s water-related charges.[4] In its appeal of the district court’s dismissal of its case on standing grounds, DWA argues that the regulations purport to automatically preempt fees and taxes thereby instilling standing on DWA to bring its suit. The United States argues that DWA does not have standing because the leasing regulations do not operate to preempt DWA’s water charges, nor has the U.S. Department of the Interior taken action against DWA pursuant to its leasing regulations. The appeal, pending in the Ninth Circuit, is fully briefed and argued.

In Tulalip Tribes v. Smith, the tribes and the United States seek a similar preemption of taxation by the state and Snohomish County to avoid double taxation of sales at stores at Quil Ceda Village), a tribally-chartered municipality located on federal trust land. [5] Although the Tribes built the village from the ground up resulting in the establishment of 150 businesses, the tribes are effectively precluded from imposing their own sales tax on sales to non-Indian customers resulting in a loss of tens of millions of dollars per year. In its motion for partial summary judgment, the tribes argue that they provide services to Quil Ceda Village, not the defendants and that the defendants have failed to identify any services they perform in connection with commerce at the Village. Further, the tribes and the United States argue that services offered by the defendants outside the village lie outside the scope of services analyzed under the Bracker balancing test. Like the possessory interest tax in Agua Caliente, the tribes assert that the defendants’ sales tax is a general revenue tax which is insufficient to avoid preemption. The United States agreed, arguing that a state tax must be “narrowly tailored” to achieve its interests to survive preemption. Defendants’ motion for partial summary judgment argues that Bracker only applies where the legal incidence of the tax falls on a nontribal entity engaged in a transaction with tribes or tribal members and does not apply to the village where the transactions are between non-Indian customers and non-Indian stores.

Challenges to state sales, business and occupancy taxes on gaming related activities

In two recent cases, tribes have contested the application of state sales taxes on alcohol sales at tribal casinos, though on slightly different grounds. In *Citizen Potawatomi Nation v. State of Oklahoma*, [6] the state demanded revocation of the Nation’s alcoholic beverage permits on the grounds that the nation failed to remit sales tax to the state on the nation’s sale of goods and services to nontribal members at its casino, questioning more than \$27 million dollars in exceptions to state sales tax claimed by the nation. An arbitrator subsequently determined that the sales tax was preempted based under Bracker. Notably, the arbitrator reasoned that the nation “alone invests in the value of goods and services that it sells” and “does not derive such value through an exemption from State sales tax” and that the state possessed “no economic interest beyond general a general quest for additional revenue.” The federal district court upheld the arbitrator’s decision in June and the state appealed the decision to the Tenth Circuit, arguing the case was not appropriately subject to arbitration, where the case is currently pending.

In a substantially similar lawsuit, *Flandreau Santee Sioux Tribe v. Andy Gerlach et al.*, [7] the state refused to renew the casino’s alcohol licenses when the tribe refused to remit sales tax it owes, though the relevant gaming compact is silent on the issue of state sales tax. On the heels of a denial of the state’s motion for judgment on the pleadings in late 2015, in 2016, the district court granted judgment on the pleadings to the tribe declaring that alcohol sales at a casino can be directly related to class III gaming

under the Indian Gaming Regulatory Act, and therefore, may potentially be preempted from state sales and use tax.

In *Keweenaw Bay Indian Community v. Nick Khouri et al.*, [8] the tribe seeks to preempt the state of Michigan's sales and use taxes levied against the tribe and its members within the reservation on trust lands, and to enjoin interference in its transport of unstamped cigarettes delivered from other tribes' wholesalers on the basis of the supremacy clause of Article VI of the United States Constitution, the Indian Trader Statutes and under *Bracker*. The state has answered, however, no substantive rulings have yet been issued in the case.

Challenge to state tax on the utilities provided to tribes

In *Seminole Tribe of Florida v. Stranburg*, [9] the tribe argued that the legal incidence of a tax on gross receipts for utility services, added to customer bills and then remitted by the service provider to the state, fell on the tribe and therefore was invalid under federal law. The Eleventh Circuit disagreed, holding that the legal incidence of the utility tax rests with the utility provider because the statute imposes a duty on the provider to remit the tax collected from the customer and that the legal incidence falls on the customer only when the pass-through is mandatory. Therefore, the Court of Appeals ruled, the tax did not violate federal law. On remand, the district court declined to hear new evidence or arguments in support of a *Bracker* balancing analysis and granted final judgment to Stranburg.

Challenge to state ad valorem tax involving Carcieri

The Poarch Band of Creek Indians brought suit on May 26, 2015 to enjoin a county tax assessor attempting to impose an ad valorem tax on property that the United States has held in trust for the tribe for decades. The assessor contended the Poarch Band's reservation and trust lands are not eligible for tax exemption because the secretary allegedly had no authority to take the land into trust under *Carcieri v. Salazar*, 555 U.S. 379 (2009). *Carcieri* held that the Indian Reorganization Act, by its terms, limited the secretary of the interior's authority to take land into trust for Indians to those tribes that were under federal jurisdiction when the IRA was enacted in 1934. The assessor argued that because the Poarch Band was not officially recognized as an Indian tribe until 1984, it was not eligible to have lands transferred into federal trust beyond the reach of state and local taxation, and therefore, the secretary's action was unauthorized.

Poarch Band argued that "Carcieri did not abrogate the legal effects of prior secretarial entrustment decisions that were not before the Court, nor did it condone untimely or collateral challenges to federal agency decisions." On July 11, 2016, the Eleventh Circuit affirmed the district court's preliminary injunction barring the county assessor from assessing taxes on the trust lands. [10] The court ruled that the county assessor could not collaterally challenge a 30-year old land-into-trust decision and that "a state tax assessment would amount to irreparable violation of tribal sovereignty." *Id.* On September 12, 2016, the Southern District of Alabama dismissed all of the assessor's counterclaims challenging the trust status of the tribe's land.

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DISCLAIMER: Kilpatrick Townsend is counsel to the Agua Caliente Band of Cahuilla Indians and the Poarch Band of Creek Indians in the tax matters referenced in this article.

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[1] Case No. ED CV 14-0007 DMG (C.D. Cal 2014).

[2] 448 U.S. 136 (1980).

[3] Case No. ED CV 14-0007 DMG (citing Seminole Tribe of Florida v. Stranburg, 799 F.3d 1324, 1338 (11th Cir. 2015)).

[4] Desert Water Agency v. United States, Case No. 13-vc-00606 (C.D. Cal. 2013), Case No. 14-55461 (9th Cir. 2014).

[5] Case No. 2:15-cv-00940-BJR (W.D.Wash. filed Jun. 12, 2015).

[6] Case No. CIV-16-361-C (W.D. Okla. June 21, 2016).

[7] Case 4:14-cv-041771 (D.C.S.D., filed Nov. 18, 2014).

[8] Case 2:16-cv-00121 (W.D. Mich., filed May 20, 2016).

[9] 799 F.3d 1324 (11th Cir. 2015).

[10] — Fed. Appx. — (11th Cir., Jul. 11, 2016).