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MEMORANDUM

March 8, 2017

TO: Tribal Tax Policy Clients

FROM: Joe Webster /s/ and Michael Willis /s/

RE: ***Tax Policy Developments***

Ninth Circuit Upholds the Dismissal of California Water Agency's Challenge to the Tax Preemption Provisions of Interior's Land Leasing Regulations

In an opinion issued on March 7, 2017, the U.S. Court of Appeals for the Ninth Circuit affirmed the district court's dismissal of a challenge by a California State water agency against the state tax preemption provisions of the Bureau of Indian Affairs' (BIA) Indian Land Leasing Regulations. In *Desert Water Agency v. U.S. Department of the Interior*, the Desert Water Agency (DWA)[1] sought a federal court ruling that 25 C.F.R. § 162.017 of the BIA Leasing Regulations would not preclude the application of taxes and fees that DWA imposes on the water supplies and water services provided to lessees of lands within the Agua Caliente Reservation. Section 162.017(c) of the regulations states as follows:

> "What taxes apply to leases under this part?
>
> … (c) Subject only to applicable Federal law, the leasehold or possessory interest is not subject to any fee, tax, assessment, levy, or other charge imposed by any State or political subdivision of a State. Leasehold or possessory interests may be subject to taxation by the Indian tribe with jurisdiction."

DWA put forward two alternative theories as to why the state tax preemption provisions in § 162.017(c) would not apply. First, DWA argued that the phrase, "subject only to applicable Federal law," is intended to incorporate the balancing test from *White Mountain Apache v. Bracker*, 448 U.S. 136 (1980) and that under that test, DWA's charges are enforceable and not preempted. In the alternative, the DWA argued that if the BIA regulations override *Bracker* and directly preempt DWA's charges, the BIA regulations must be invalidated on the ground that the Department of Interior lacked authority to rewrite existing law through regulation.

[1] The DWA provides water services in Riverside County, California.

The district court concluded that the DWA lacked standing to bring its claims because DWA did not show that the BIA regulations caused the DWA to change its conduct, that any water users were refusing to pay fees to DWA based on the BIA regulations, or that DWA currently faced any injury that is "concrete, imminent, or even threatened" based upon the new BIA regulations.

The district court further concluded that even if DWA could meet standing requirements, DWA's allegations were not ripe for judicial review because, even if the BIA's leasing regulations change existing law to override the *Bracker* balancing test, the DWA did not show § 162.017 will affect DWA's ability to collect its fees. The court noted the grandfathering provisions of the new leasing regulations provide that the regulations do not apply to leases approved prior to January 4, 2013. Without any evidence of direct and immediate hardship to the DWA from the BIA regulations, the district court concluded it had no jurisdiction to review the claims.

In reviewing *de novo* the district court's conclusion on standing, the Ninth Circuit first sought to establish the meaning of § 162.017 in order to assess whether it caused injury to DWA that could be redressed by the court. The Ninth Circuit looked to Interior's interpretation of § 162.017, the regulatory text and judicial interpretations of that provision. The Department of Interior argued to the court that § 162.017 simply clarifies the agency's view that under the *Bracker* balancing test, the federal and tribal interests at stake are strong enough to have a preemptive effect. Whether a specific state tax is preempted under *Bracker*, Interior suggested, is a matter for the courts to determine based on the specific facts at issue in each case. The Ninth Circuit agreed with Interior and concluded that the regulatory text in § 162.107 contains the caveat, "subject only to applicable federal law", which serves to incorporate the *Bracker* test and applicable federal statutes into the regulation.

In examining other judicial interpretations of § 162.017, the Ninth Circuit underscored that the Eleventh Circuit's analysis of § 162.017 in *Seminole Tribe of Florida v. Stranburg*, 799 F.3d 1324 (11th Cir. 2015), was also consistent with Interior's interpretation. The Ninth Circuit pointed out that in examining § 162.017's effect on two Florida taxes challenged by the Seminole Tribe, the Eleventh Circuit found § 162.017 to "serve as evidence of the federal and tribal interests involved" but did not weigh the state's interest in the tax, thereby requiring the court to conduct its own "particularized inquiry" under *Bracker*.

The Ninth Circuit also recalled its own ruling in the case of Confederated Tribes of the *Chehalis Reservation v. Thurston Cty. Bd. of Equalization*, 724 F.3d 1153 (9th Cir. 2013). In that case the effort by a county to impose its property taxes upon permanent improvements on trust lands (constructed through a partnership between the Tribes and the Great Wolf Lodge), the Ninth Circuit found no need to rely on § 162.017 for its conclusion because that provision "merely clarifies and confirms" existing law. *Id*. at 1157 n.6.

Based on the text of the regulation and the administrative and judicial interpretations to date, Ninth Circuit concluded that § 162.017 serves to confirm existing law. For this reason, § 162.017 does not in itself "require or forbid DWA to change its behavior in any way." Because § 162.017 does not itself preempt DWA's charges, the Ninth Circuit concluded, the regulation does not cause injury to DWA and therefore, just as the district court held, DWA lacks standing and its case must be dismissed.

The Ninth Circuit also refused to apply the *Bracker* balancing test to determine whether leaseholders could refuse to pay DWA on the grounds that the taxes were preempted by the regulation. "The proper vehicle to resolve that question is a suit between DWA and one of the leaseholders…", said the court. Because no leaseholders were parties to this case between DWA and Interior, the Ninth Circuit found it had no jurisdiction to review that issue. To do so would constitute an "advisory opinion in a controversy which has not arisen," the court concluded.

The Ninth Circuit's evaluation of § 162.017 in this case provides important judicial interpretation of this relatively new regulation. Consistent with the Eleventh Circuit and Department of Interior's views, the Ninth Circuit has found the tax preemption provisions of the leasing regulations clarify that strong federal and tribal interests associated with the leasing of Indian lands have the force to preempt state taxation of leaseholder activities. Given that *Bracker* requires a "particularized inquiry" into the federal, tribal and state interests at stake, and given that the regulation does not examine the specific state interests at stake, § 162.017 cannot on its own preempt a state tax. Although the federal courts will still be called upon to conduct the *Bracker* balancing test, the courts now have the benefit of the Department of Interior's regulations setting forth compelling federal and tribal interests to be weighed against the state interest in the tax.

Conclusion

We will continue to monitor tax developments on your behalf. Please contact us if you have any comments or questions.