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MEMORANDUM

October 6, 2014

To: Kitcki Carroll, Executive Director
United South and Eastern Tribes (USET)

From: Joe Webster /s/ and Michael Willis /s/
Hobbs Straus Dean & Walker, LLP

Re: ***Federal Court Applies BIA Leasing Regulations in Finding that Federal Law Preempts State Rental and Utility Taxes on the Seminole Indian Reservation***

In early September, the U.S. District Court for the Southern District of Florida agreed with the Seminole Tribe of Florida ("the Tribe") that federal law prohibits the State from imposing its rental tax and its utility tax on properties and businesses on the Tribe's reservation.[1] The decision is the first time a federal court has applied and deferred to the Bureau of Indian Affairs' (BIA) new leasing regulations (25 C.F.R. Part 162) in ruling that federal law prohibits state taxation on activities taking place on an Indian reservation. As discussed below, the court's decision and its application of the new BIA land leasing regulations offers important favorable precedent that may help tribes prevent other governments from taxing economic activities on their reservations and allow tribes to more fully benefit from the revenues generated in Indian Country.

Since the United States Supreme Court's ruling in *Cotton Petroleum v. New Mexico*, 490 U.S. 163, 176 (1989), economic development on Indian lands has been burdened by the application of state and local government taxes on the private parties with whom an Indian tribe does business, even though the financial burden of those taxes may fall on the tribe. Under the tax rules emerging from the *Cotton Petroleum* ruling and the body of Indian tax cases, a state cannot tax the United States directly (and, correspondingly, cannot tax reservation lands held in trust by the United States for tribes). When a tribe engages non-Indian partners on its reservation, however, the courts apply a balancing test to assess the federal, tribal and state interests at stake.[2]

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[1] *Seminole Tribe of Florida v. State of Florida*, No. 12-62140 (S.D. Fla. Sept. 4, 2014).

[2] *See White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980); *see also Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 836-37 (1982) (explaining that the balancing test is used to "confront the difficult problem of *reconciling* the plenary power of the States over residents within their borders with the semi-autonomous status of Indians living on tribal reservations").

Tribes have taken various approaches to mitigate the damaging impact of multiple layers of taxation that has been permitted since *Cotton Petroleum*. Although tribes have authority to tax nonmembers doing business in Indian Country, when other jurisdictions can tax those same nonmembers for the same transactions, tribes must lower their tax to keep overall pricing at rates the market can bear or forego levying a tax at all. As a result, state and local governments often reap the tax benefits of increased economic activity on Indian reservations.

In the *Seminole* case, the Tribe challenged Florida's imposition of the State's rental tax on businesses that lease property from the Tribe and challenged the State utility tax on electricity delivered to the Tribe's lands.

The Rental Tax. The court rejected the rental tax on two grounds. First, the court relied on 25 U.S.C. § 465, which prohibits a state from taxing a tribe's trust lands and the permanent improvements on that trust land. *See* Slip Opinion at 3 (citing *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 158 (1973)). The court reasoned that the State's rental tax interfered with the Tribe's property rights associated with its trust lands, including the rights to manage the property, earn income from the property, choose who leases the property and determine how the property is used. Given these forms of interference with the Tribe's property rights, the court concluded that "a tax upon a lease is a tax upon the property itself." *Id*.

The court devoted considerably more attention and analysis to its second ground for rejecting the application of the State's rental tax on the Tribe's reservation: that federal law governing the leasing of Indian lands preempts the State's rental tax. The court pointed out that "Current federal regulations expressly prohibit the Rental Tax, as applied to tribal leases." Slip Opinion at 4 (quoting the BIA's Indian land leasing regulations at 25 C.F.R. § 162.017(a) ("the leasehold or possessory interest is not subject to any fee, tax, assessment, levy, or other change imposed by any State or political subdivision of a State"). The court then summarized key elements of the Department of the Interior's rulemaking process that resulted in the promulgation of the leasing regulations, particularly the tax provisions set forth in 25 C.F.R. § 162.017. The court noted that the Secretary of the Interior's "comprehensive evaluation of existing federal law" concluded that "[t]he Federal statutory scheme for Indian leasing is comprehensive, and accordingly precludes State taxation [of Indian leases]." *Id*. (quoting the preamble to the BIA Indian land leasing regulations, 77 Fed. Reg. 72440–01, at *72447–72448 (December 5, 2012).

The court determined that the Secretary's extensive analysis of federal Indian tax law and the comprehensive nature of the Indian land leasing regulations require the court to "give weight to" the Secretary's rule. Indeed, the court relied on the leasing regulations to conclude "that the federal regulatory scheme regarding leases of restricted Indian land is so pervasive that it precludes the additional burdens imposed by Florida's Rental Tax." Notably, in deferring to the new regulations the court also distinguished the *Seminole* case from *Cotton Petroleum* and *Bracker*:

> "Unlike in *Cotton Petroleum* or *Bracker*, this Court now has the benefit of the comprehensive analysis performed by the Secretary of the Interior showing how tribal interests are affected by state taxes on leases of restricted Indian land."

Slip Opinion at 4. With respect to these tribal interests, the court also elaborated on the direct economic impact of the State tax in response to the State's claim that the Tribe has not shown any economic burden from the tax. The court explained:

> "Even if such an economic burden were required, the Court in *Bracker* accepted the proposition that the state tax, although imposed on non-Indians engaged in activities on the reservation, affected the amount of revenue available to the Tribe. Of course, this is nothing more than an acknowledgment of the law of scarcity—a fundamental concept of economics…. If Florida's Rental Tax does not apply, an entity leasing tribal land will have additional money in its pocket—money that would then be available to the Tribe, either through negotiated higher rent or through a tribal tax."

Slip Op. at 8 (internal citations and quotations omitted).

The Utility Tax. The court's evaluation of the State's utility tax relied on the Supreme Court's ruling in *Oklahoma Tax Commission v. Chickasaw Nation*, which established that "a state may not directly tax an Indian Tribe on an Indian reservation unless a federal statute expressly permits the tax." 515 U.S. 450, 458 (1995). Under *Chickasaw* and the line of cases following it, the courts must determine where the "legal incidence" of an excise tax for sales made within Indian country falls, and if it falls on the tribe, it may not be enforced. Despite Florida's arguments that the legal incidence of its utility tax falls on the power company, the court found that the power company is only a payment transmitter under the Florida law. The power company remits the consumer's tax payment to the State, but the power companies are not required to pay the tax if the consumer does not. Under this analysis, the court concluded that since the consumer (here the Tribe) bears the legal incidence of the tax, the State utility tax is not permitted.

Implications for Indian Country. The *Seminole* case was frequently cited in discussions on economic development and tax policy during both the Native American Finance Officers Association (NAFOA) meeting and the annual conference of the National Intertribal Tax Alliance (NITA), which were held in California last week. The decision will be watched closely as tribes have had longstanding concerns with federal court rulings that have upheld state and local government taxes on non-Indian businesses operating in Indian Country under the interest balancing test set forth by the Supreme Court in *Bracker*. The State of Florida, on October 6, 2014, filed its notice of appeal in the case, which will put the issue before the Court of Appeals for the Eleventh Circuit. The Indian land leasing regulations have been challenged by state and local governments

in other cases pending before the federal courts. *See, e.g.*, *Desert Water Agency v. U.S. Department of the Interior*, No. 13-00606 (C.D. Cal. 2013); *and Agua Caliente Band of Cahuilla Indians v. Riverside County*, No. 14-00007 (C.D. Cal. Jan. 2, 2014).

The *Seminole* decision and its application of the Indian land leasing regulations signals new authority to empower Indian tribes to ensure that revenues generated in Indian Country remain in Indian Country for the benefit of tribal communities. Indeed, the court in *Seminole* itself observed, "[t]he Secretary of the Interior's new regulations have changed the landscape of this area of the law, specifically regarding the issue of preemption." *Seminole Tribe of Florida*, Slip Opinion at 8.

Conclusion

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