BIA Leasing Regulations

A Shift in Tax Policy?: express preemption of state taxation amid legal uncertainties.

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I. INTRODUCTION

In December 2012, the Secretary of the Interior promulgated new regulations that *amended* Part 162 of the Code of Federal Regulations, which governs the leasing of Indian lands for a variety of purposes. 25 C.F.R. Part 162 ("Leases and Permits").

Section 162.017, a wholly new section, has received a lot of attention from scholars and litigators alike because it *explicitly* prohibits states from imposing taxes, fees, assessments, levies, or other charges on:

a) permanent improvements on leased land, without regard to ownership of those improvements;
b) activities under a lease conducted on the leased premises; and
c) leasehold or possessory interest in leased land.

This prohibition against state taxation is subject "only to applicable Federal law."[1] Section 162.017 also expressly states that tribes may tax permanent improvements, activities, or leasehold interests related to leases that are approved under Part 162 so long as the tribe has jurisdiction to impose and collect any such taxes.

This express preemption of state taxes represents a major shift in tax policy. This regulation undermines states' taxing jurisdiction in Indian Country, despite case law holding to the contrary. *See, e.g.*, *Fort Mojave Tribe v. Cnty. of San Bernadino*, 543 F.2d 1253 (9th Cir. 1976) (upheld state's possessory interest tax imposed on lessee of Indian land). Over the years, courts have relied on the infamous *Bracker* balancing test to determine the scope and extent of the states' taxing authority in Indian Country. *See White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980). Historically, the *Bracker* balancing test has been applied when federal law is ambiguous. Now, many tribal attorneys are speculating about whether Section 162.017 eliminates the need for the *Bracker* test when determining the validity of state taxes on lands leased under Part 162.

Yet whether tribes can successfully rely on Section 162.017 to prevent the state and local jurisdictions from imposing such taxes is yet to be determined.

[1] Although Section 162.017 provides that such prohibition is subject "only" to federal law, the applicability of this section is limited under Section 162.008, which provides that leases approved before January 4, 2013, may govern "if provisions of the lease document conflict with this part." 25. C.F. R. § 162.008(a). Moreover, Section 162.017 only governs particular types of leases. 25 C.F.R. § 162.006.

II. WHAT HAPPENS NEXT? – A Tale of Three Possible Outcomes.

Many states will undoubtedly dispute the scope and legal effect of Section 162.017. *See, e.g.*, *Seminole Tribe of Florida v. State of Florida*, Department of Revenue, No. 12-62140 (S.D. Fla. Sept. 5, 2014); *Desert Water Agency v. U.S. Dep't of Interior*, No. 5:13-cv-00606-DMG-OP (C.D. Cal. 2013); *Agua Caliente Band of Cahuilla Indians v. Riverside Cnty.*, No. 5:14-CV-00007, 2014 WL 487188 (C.D. Cal. Jan. 2, 2014) (complaint for declaratory and injunctive relief). Court will likely resolve these disputes. This section attempts to outline three possible outcomes of any such litigation.

1. "Pie in the sky" – States taxation is expressly preempted.

Section 162.017 flatly prohibits state taxation. This unambiguous regulation should preempt conflicting state and local taxation, under the Supremacy Clause, so long as regulation has the "force and effect of law." *See, e.g.*, *City of Arlington, Tex. v. F.C.C.*, 133 S. Ct. 1863 (2013). Regulations have the force and effect of law if the agency had discretion to promulgate the rules. The Secretary of the Interior had authority to promulgate the leasing regulations pursuant to the Long Term Leasing Act of 1955, which delegates authority to the Secretary of the Interior to approve tribal commercial leases "under such terms and regulations as may be prescribed." 25 U.S.C. § 415(a).

Courts should uphold express regulations because federal agencies are entitled to deference when the agency promulgates regulations pursuant to congressionally delegated rule-making authority. *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). Under *Chevron*, an agency's regulation will be overturned only if arbitrary or clearly contrary to federal law. As argued by Joseph Lennihan,[2] the new leasing regulations "reflect a reasonable exercise of the Secretary's discretion" because the Secretary acts as a "steward of tribal lands" and because the regulations clarify the extent of the state's taxing authority, which has been muddled by conflicting case law.

2. "Narrow Win" – State taxation is preempted under *Bracker*.

Even if the courts are unwilling to hold that Section 162.017 expressly preempts any conflicting state laws, courts may nevertheless afford "some weight and deference" to Section 162.017 such that the *Bracker* balancing test now militates in favor of preemption. *See Seminole Tribe of Florida v. State of Florida*, Department of Revenue, No. 12-62140 (S.D. Fla. Sept. 5, 2014).

In the recent *Seminole Tribe of Florida* case, the court applied the *Bracker* balancing test and held, in the alternative, that Florida's tax was preempted by federal law because "the federal regulatory scheme regarding leases of restricted Indian land is

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[2] Joseph Lennihan, *The New Indian Leasing Regulations: Express preemption of state taxation in Indian Country?*, Journal of Multistate Taxation and Incentives, September 2013.

so pervasive that it precludes the additional burdens imposed by Florida's Rental Tax." *Seminole Tribe of Florida*, Slip Opinion at page 6.

3. "Plan B" – Utilizing 25 U.S.C. § 465 and the *Chehalis* case.

Tribal attorneys may be able to rely on 25 U.S.C. § 465, which exempts tribal trust land from state taxation, in order to assert that lessees of tribal trust lands are not subject to state taxes on possessory interests in trust land or permanent improvements on trust land.

The Supreme Court has already determined that Section 465 exempts trust land and rights in any such trust land but it does not exempt income derived from the land's use. *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 155 (1973) (held that state's use tax was preempted by Section 465). Applying this rule, the Ninth Circuit Court of Appeals recently determined that Section 465's prohibition against state taxation of trust land "extends to permanent improvements on such lands." *Confederated Tribes of the Chehalis Reservation v. Thurston Cnty.*, 724 F.3d. 1153, 1155 (9th Cir. 2013).

It is difficult to predict whether federal courts will be amenable to extending Section 465 exemption to state taxes on possessory interests in trust land. Arguably, possessory interests are "intimately connected" with the land, in the same way that permanent improvements are inextricably tied to the trust land. *See Mescalero*, 411 U.S. at 158. *See also*, *Florida Seminole Tribe*, Slip Opinion at page 3 (held that Florida's rental tax imposed on lessee of tribal trust land was prohibited by Section 465). Yet, there is case law that explicitly upholds the validity of the state of California's possessory interest tax on tribal trust land. See *Fort Mojave Tribe,* 543 F.2d 1253.

Although Section 465 may provide legal authority for invalidating state taxes imposed on lessee's possessory interests and permanent improvements located on trust land, in my opinion, *Mescalero* forecloses the option of relying on Section 465 for the exemption of "activities" on leased Indian lands because such activities represent income derived from the land. *See Mescalero*, 411 U.S. at 155.

III. CONCLUSION

Despite these looming legal uncertainties, I remain hopeful that Section 162.017 will equip tribal governments with another legal tool for ousting state taxing authorities from Indian Country.