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IN THE UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

EASTERN DIVISION

TWENTY-NINE PALMS BAND OF MISSION INDIANS, a federally recognized Indian Tribe,

Plaintiff,

v.

SELVI STANISLAUS, in her official capacity as Executive Officer of the Franchise Tax Board, JOHN CHIANG, in his official capacity as Member and Chair of the Franchise Tax Board, BETTY T. YEE in her official capacity as a Member of the Franchise Tax Board and ANA MATOSANTOS in her official capacity as a Member of the Franchise Tax Board,

Defendants.

EDCV08-1753 VAP (OPx)

DEFENDANTS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION TO DISMISS PLAINTIFF'S THIRD AMENDED COMPLAINT

(Fed. R. Civ. P. 12(b)(6))

Oral Argument Requested

Date: May 10, 2010
Time: 10:00 a.m.
Courtroom: 2
Judge The Honorable Virginia A. Phillips
Trial Date: n/a
Action Filed: 12/2/2008

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INTRODUCTION

Defendants Selvi Stanislaus, Executive Officer of the California Franchise Tax Board (FTB), John Chiang, California State Controller and Ex-Officio Member and Chair of the FTB, Betty T. Yee, Chair of the California State Board of Equalization and Ex-Officio Member of the FTB, and Ana Matosantos, Director of the California Department of Finance and Ex-Officio Member of the FTB (collectively, State Defendants), move to dismiss Plaintiff Twenty-Nine Palms Band of Mission Indians' (Tribe) Third Amended Complaint (TAC) (Doc. 53) because it fails to state a claim upon which relief can be granted. *See* Fed. R. Civ. P. 12(b)(6).

The Tribe asserts that the State Defendants' efforts to impose personal income tax liability on Tribal members' per capita payments or casino wages is preempted by federal law and interferes with Tribal sovereignty. The TAC fails to state a claim for relief that is cognizable as a matter of law because, under federal common law, while a tribal member living on her tribe's reservation is ordinarily exempt from state personal income tax on income earned from on-reservation activities, in this case no Tribal member lives on the Tribe's reservation. The Tribe's attempt to explain why its members live off-reservation is irrelevant to a determination whether the exemption applies.

In addition, the TAC fails to state a claim for federal preemption because in the Indian Gaming Regulatory Act (IGRA), 18 U.S.C. §§ 1166-1168, 25 U.S.C. §§ 2701-2721, Congress did not impliedly[1] preempt states from imposing personal income tax on individual Tribal members living off-reservation. Moreover, although not clearly alleged as preemptive, the tax is also valid under the Indian Commerce Clause because it is applied in a nondiscriminatory manner. Finally, tribal sovereignty is not an independent basis for relief in this action. Nonetheless,

[1] This Court previously found that IGRA did not expressly preempt the state tax at issue here but allowed the Tribe to amend its complaint to allege implied preemption under IGRA. (Doc. 33 at 15-16.)

the TAC fails to state a claim for relief on the theory that the tax infringes upon Tribal self-governance.

This motion is made following the conference of counsel pursuant to Local Rule 7-3, which took place on October 23 and 27, 2009.

BACKGROUND

The following is based upon allegations in the TAC and matters properly subject to judicial notice, as set forth in the State Defendants' accompanying request for judicial notice (Defs.' RJN). The Tribe is a federally recognized Indian tribe with twelve adult members. (TAC ¶¶ 1, 6, 11.) Its reservation[2] includes about 240 contiguous acres located in the Cities of Indio and Coachella in Riverside County, and 160 contiguous acres separately located within the City of Twentynine Palms in San Bernardino County. (*Id.* ¶ 12; Act of Apr. 21, 1976, Pub. L. No. 94-271, 90 Stat. 373 (Apr. 21, 1976); Defs.' RJN Ex. A, Pres. Proclamation (Nov. 11, 1895).)

The Tribe operates a casino on part of its reservation located in Coachella. (TAC ¶¶ 3, 14.) Some Tribal members are "employed by the Tribe relative to issues involving the Casino." (*Id.* ¶ 20.) No Tribal members live on the reservation. (*Id.* ¶¶ 21, 23.) The Tribe alleges there is no housing on its reservation because it would be "financially, socially and politically very difficult" to put housing there. (*Id.* ¶ 21.) According to the Tribe, there is no housing on the reservation in Coachella because a large part is taken up by the casino and parking lot, and the remainder cannot be used for residential purposes. (*Id.*) Nor is there housing on the reservation in Twentynine Palms because the land is undeveloped and cannot be used for housing. (*Id.* ¶ 22.)

[2] The State Defendants refer to the Tribe's trust land as a reservation for ease of reference. They take no position here as to whether the land constitutes a reservation under federal law.

Nonetheless, in December 2007 the Tribe issued a press release indicating that it proposed to develop a second casino, hotel, RV park and residential housing on the reservation in Twentynine Palms. (Defs.' RJN Ex. B, Tribal press release (Dec. 12, 2007).) In March 2007, the Tribe issued a press release indicating that it was beginning construction to expand its casino in Coachella. (*Id.* Ex. C, Tribal press release (Mar. 20, 2007).) The expansion includes construction of a new casino and parking area; remodeling the existing casino; and construction of a new casino wing, including a 200-room hotel and 78,000-square foot conference space. (*Id.* Ex. D, Draft Envtl. Assessment, Spotlight 29 Casino Expansion (Nov. 11, 2000) 10.) According to the Draft Environmental Assessment prepared for the casino expansion project,

> There are no known cultural resources associated with the project site, and the site has not been previously used for religious or cultural events by the [Tribe]. A letter from the [Tribe] documenting this finding, dated March 21, 1994, stated that the Reservation is not the ancestral lands of the [Tribe] and has no cultural or religious significance to the [Tribe].

(*Id.* 2-6; *see also id.* 2-7 (noting the reservation in Coachella is "not a traditional homeland") & 3-6.) In addition, "[n]one of the [Tribe] currently live on the Reservation, or plan to live on the Reservation after development of this project, preferring to live in nearby housing." (*Id.* 2-16.)

On February 18, 2008, nearly ten months before the Tribe filed this action, it submitted to the Department of the Interior, Bureau of Indian Affairs (BIA) an application for the United States to accept in trust for the Tribe's benefit title to a 47.31-acre parcel of Tribal-owned, undeveloped fee land located adjacent to the reservation in Coachella. (Defs.' RJN Ex. E, Tribe's Trust Land Application (Feb. 18, 2008).) The Tribe requested the BIA to acquire the land in trust not for housing but to "land bank" the property for some future, unknown commercial development. (*Id.*) The application is pending.

According to the Tribe, it periodically prepares a Revenue Allocation Plan, pursuant to IGRA, that details, among other things, how casino revenue is distributed to members, also known as "per capita payments." (TAC ¶ 16.) The Tribe alleges its Revenue Allocation Plan considers, among other things, the members' obligations to pay federal income taxes on per capita payments, but not state personal income tax. (*Id.* ¶ 17.) The Tribe also alleges that its Gaming Ordinance "dictates how net revenues of gaming activity after payment of management fees may be used." (*Id.* ¶ 19.)

The Tribe claims that State Defendants' efforts to impose and collect state personal income tax upon Tribal members' per capita payments or casino employment wages are preempted by federal law and infringe upon Tribal sovereignty. (*Id.* ¶¶ 5, 17, 28-29.) The Tribe alleges that it and its members bear the legal incidence of the tax (*id.* ¶¶ 10, 25), and that the tax "falls directly on the reservation" (*id.* ¶ 26). The Tribe seeks injunctive and declaratory relief. (*Id.* 11, Prayer ¶¶ 1-2.)

STANDARD ON MOTION TO DISMISS

Under Federal Rule of Civil Procedure 12(b)(6), a claim may be dismissed either because it asserts a legal theory that is not cognizable as a matter of law or because it fails to allege sufficient facts to support an otherwise cognizable legal claim. *SmileCare Dental Group v. Delta Dental Plan of California, Inc.*, 88 F.3d 780, 783 (9th Cir. 1996).

> All allegations of material fact are taken as true and construed in the light most favorable to the nonmoving party. The court need not, however, accept as true allegations that contradict matters properly subject to judicial notice or by exhibit. Nor is the court required to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences.

Sprewell v. Golden State Warriors, 266 F.3d 979, 988 (9th Cir. 2001) (citations omitted) (*Sprewell*).

ARGUMENT

THE THIRD AMENDED COMPLAINT FAILS TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED AGAINST THE STATE DEFENDANTS

A. Federal Common Law Permits State Taxation of Indians Living Off-reservation

The Tribe alleges that the State Defendants' efforts to impose and collect personal income tax on Tribal members' casino employment wages and per capita payments are preempted by federal law. (TAC ¶ 29.) Federal common law, however, authorizes states to tax the personal income of Indians living off-reservation.

The income of a California resident is ordinarily taxable by California regardless of the source. Cal. Rev. & Tax. Code § 17041. The Supreme Court has held that it is the "sovereign right" and "ordinary prerogative" of a state to "tax the income of every resident," including "income earned outside the taxing jurisdiction." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462-63, 464, 466, 115 S. Ct. 2214, 132 L. Ed. 2d 400 (1995). Only a tribal member living on her tribe's reservation *and* earning income from on-reservation sources is exempt from state personal income tax on that income. *McClanahan v. Arizona Tax Comm'n*, 411 U.S. 164, 168-71, 93 S. Ct. 1257, 36 L. Ed. 2d 129 (1973) (*McClanahan*). This has been referred to as the "*McClanahan* presumption against state tax jurisdiction." *Oklahoma Tax Comm'n v. Sac & Fox Nation*, 508 U.S. 114, 123, 113 S. Ct. 1985, 124 L. Ed. 2d 30 (1993). Indians "going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State," including tax laws. *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148-49, 93 S. Ct. 1267, 36 L. Ed. 2d 114 (1973).

Here, the Tribal members do not qualify for the *McClanahan* exemption, regardless of the source of income, because they live off-reservation. (TAC ¶¶ 21, 23.) "Domicil [sic] itself affords a basis for such taxation. . . . Neither the privilege nor the burden is affected by the character of the source from which the income is derived." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. at 463 (internal quotation marks and citation omitted); *see Lac Du Flambeau Band of Lake Superior Chippewa Indians v. Zeuske*, 145 F. Supp. 2d 969, 976 (W.D.Wis. 2000) ("[t]he state may tax persons resident within its borders who do not live on reservations because it has conferred upon these persons the benefit of domicile and its accompanying privileges and advantages"). The mere fact that an Indian's income derives from per capita payments from an on-reservation casino, or employment at that casino, is insufficient to immunize it from state taxation. The taxpayer must reside on her member reservation where she earned the income. *See McClanahan*, 411 U.S. at 170-71; *Osage Nation v. Oklahoma ex rel. Oklahoma Tax Comm'n*, 597 F. Supp. 2d 1250, 1262 (N.D. Okla. 2009) ("*McClanahan* never established either an exemption applying categorically to all tribal members living in Indian country, or an exemption which applied, regardless of the source of the tribal member's income"; finding tribe could not qualify for *McClanahan* exemption from state income tax because there were no qualifying reservations in Oklahoma), *aff'd sub nom. Osage Nation v. Irby*, No. 09-5050, 2010 WL 745718 (10th Cir. Mar. 5, 2010).

The Tribe offers several explanations why it cannot put housing on its reservation but the reason tribal members do not live on their membership reservation has never been relevant to the determination of whether the *McClanahan* exemption applies. For instance, in *Jefferson v. Commissioner of Revenue,* 631 N.W.2d 391, 395 n.4 (Minn. 2001), the Minnesota Supreme Court rejected as irrelevant tribal members' argument that because they had been "forced off the reservation and intended to return to the reservation," their on-reservation

income was exempt from state taxation. Recently, and more directly on point, in *Mike v. Franchise Tax Board*, No. D054439, 2010 WL 744297, at *7 (Cal. Ct. App. Mar. 5, 2010), the California Court of Appeal held that a member of the Twenty-Nine Palms Band that resides off the Tribe's reservation but on the reservation of another tribe of which she is not a member is not entitled to the *McClanahan* exemption because "an essential ingredient for the exemption—residence on lands set aside for the tribe in which she is a member and from which the income derived—is absent here." This Court should reach the same conclusion. The allegations why there is no on-reservation housing is irrelevant. No Tribal members live on the reservation and, therefore, none is entitled to the *McClanahan* exemption.

B. The Tax is Valid Under the Supremacy Clause

Although the TAC is not entirely clear, the Tribe suggests that IGRA preempts California's imposition of personal income tax on its members living off-reservation. (TAC ¶¶ 15-17, 25-26; *compare* Second Amended Compl. (SAC) (Doc. 35) ¶ 29 (specifically alleging tax preempted by IGRA, among other federal laws) *with* TAC ¶ 29 (vaguely alleging tax preempted by "federal law"). The tax, however, does not intrude into an area preempted by IGRA, and thus does not violate the Supremacy Clause.

The Supreme Court has warned "against interpreting federal statutes as providing tax exemptions unless those exemptions are clearly expressed." *Chickasaw Nation v. United States*, 534 U.S. 84, 95, 122 S. Ct. 528, 151 L. Ed. 2d 474 (2001) (citing cases); *see also Mescalero Apache Tribe v. Jones*, 411 U.S. at 156 ("absent clear statutory guidance, courts ordinarily will not imply tax exemptions and will not exempt off-reservation income from tax simply because the land from which it is derived, or its other source, is itself exempt from tax"); *County of Yakima v. Confederated Tribes & Bands of Yakima Indian Nation*, 502 U.S. 251, 267, 112 S. Ct. 683, 116 L. Ed. 2d 687 ("'Either Congress intended to

pre-empt the state taxing authority or it did not. Balancing of interests is not the appropriate gauge for determining validity since it is that very balancing which we have reserved to Congress.'") (*quoting Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134, 177, 100 S. Ct. 2069, 65 L. Ed. 2d 10 (1980) (opinion of Rehnquist, J.)). This Court previously rejected the Tribe's argument that IGRA expressly preempts the tax but nonetheless allowed the Tribe to amend its complaint to state a claim for implied preemption. (Doc. 33 at 15-16.)

A claim for implied preemption requires proof that Congress intended federal law to occupy the legislative field, or that state law conflicts with a federal statute. *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372, 120 S. Ct. 2288, 147 L. Ed. 2d 352 (2000) (citations omitted). Preemption exists where it is impossible for a private party to comply with both state and federal law and where the state law is an obstacle to the accomplishment and execution of Congress's full purposes and objectives. *Id.* (citations omitted). What is a sufficient obstacle is determined by examining the federal statute and identifying its purpose and intended effects. *Id.*

"Through IGRA, Congress comprehensively regulates Indian gaming" and "how casinos function" to "assure the gaming is conducted fairly and honestly by both the operator and players." *Barona Band of Mission Indians v. Yee*, 528 F.3d 1184, 1192-93 (9th Cir. 2008) (*citing* 25 U.S.C. § 2702(2)). The Tribe does not allege that California's personal income tax interferes with governance of gaming activities or the decision as to which gaming activities are allowed. *See County of Madera v. Picayune Rancheria of Chuckchansi Indians*, 467 F. Supp. 2d 993, 1002 (E.D. Cal. 2006) (*citing Confederated Tribes of Siletz Indians v. Oregon*, 143 F.3d 481, 486 n.7 (9th Cir. 1998); *Gaming Corp. of America v. Dorsey & Whitney*, 88 F.3d 536, 550 (8th Cir. 1996)). Indeed, this case does not at all involve the regulation of gaming activities. Although the Tribe alleges that it "operates its Casino pursuant to the [Revenue Allocation Plan]" (TAC ¶ 20), the Court need not accept this allegation as true because it contradicts judicially noticeable provisions

in 25 C.F.R. § 290.4 (2008), which defines a Revenue Allocation Plan as the document a tribe submits to the BIA that describes how the tribe will allocate net gaming revenues, and 25 C.F.R. § 290.12, which specifies information that must be included in a Revenue Allocation Plan. *See Sprewell*, 266 F.3d at 988 (court need not accept as true allegations contradicted by matters properly subject to judicial notice). (Defs.' RJN Ex. F, 25 C.F.R. § 290, Tribal Revenue Allocation Plans.) A Revenue Allocation Plan has nothing to do with how a tribe operates its casino. *E.g.*, *compare* 25 C.F.R. § 290 (Tribal Revenue Allocation Plans) *with* § 291 (Class III Gaming Procedures) & § 542 (Minimum Internal Control Standards for gaming operations on Indian land). Thus, IGRA's comprehensive regulation of Indian gaming does not occupy the field with respect to state personal income tax imposed on Tribal members that work at the casino or receive per capita payments from net gaming revenue.

In addition, the tax does not violate IGRA's purpose to "promote tribal economic development, tribal self-sufficiency, and strong tribal government" by "ensur[ing] that the Indian tribe is the primary beneficiary of the gaming operation." *See* 25 U.S.C. § 2702(1)-(2). The Tribe alleges no facts demonstrating how IGRA preempts state income tax on Tribal members' casino employment wages. Absent supporting factual allegations, the claim should be dismissed.[3] Instead, the Tribe relies exclusively upon IGRA's allowance of per capita payments made pursuant to a federally-approved Revenue Allocation Plan and its Tribal Gaming Ordinance to demonstrate preemption. (TAC ¶¶ 15-20.) Both assertions fail, however.

[3] Indeed, the Tribe's bald allegation that some members are "employed by the Tribe relative to issues involving the Casino" (TAC ¶ 20) is not equivalent to alleging that Tribal members are actually employed by the casino. Even if it were, the failure to allege an injury in fact to the Tribe is fatal. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61, 112 S. Ct. 2130, 119 L. Ed. 2d 351 (1992).

Per capita payments are made from a tribe's net gaming proceeds to individual members for their unrestricted use and for which the tribe as a whole is not a beneficiary. Federal regulations define a "per capita payment" as

> the distribution of money or other thing of value to all members of the tribe, or to identified groups of members, which is paid directly from the net revenues of any tribal gaming activity. This definition does not apply to payments which have been set aside by the tribe for special purposes or programs, such as payments made for social welfare, medical assistance, education, housing or other similar, specifically identified needs.

25 C.F.R. § 290.2.

Tribes are not required to make per capita payments. 25 U.S.C. § 2710(b)(2)(B); 25 C.F.R. § 290.8. If a tribe chooses not to make per capita payments, no Revenue Allocation Plan is required. 25 C.F.R. § 290.7. A tribe is then free to use its gaming proceeds, as allowed by IGRA, to fund government operations and programs, provide for the general welfare of the tribe and its members, promote tribal economic development, donate to charitable organizations and help local government agencies. 25 U.S.C. § 2710(b)(2)(B); 25 C.F.R. § 290.9.

If a tribe elects to make per capita payments, it can do so only after the BIA has reviewed and approved a Revenue Allocation Plan for compliance with IGRA. 25 U.S.C. § 2710(b)(3), (d)(1)(A)(ii); 25 C.F.R. §§ 290.5, 290.10, 290.11. BIA approval ensures that the payments are fair and equitable, and made only to enrolled members from gaming revenues, thus furthering IGRA's policy objectives. *Smith v. Babbitt*, 100 F.3d 556, 558 (8th Cir. 1996).

Here, the Tribe contends that its Revenue Allocation Plan is "tribal law and rule" and "dictates and details how the Tribe's net gaming proceeds must be distributed and includes per capita payments to its members." (TAC ¶¶ 16, 18.) IGRA restricts how a tribe may spend its gaming proceeds but a Revenue

Allocation Plan is only necessary here because the Tribe elects to make per capita payments. (*See id.* ¶ 15.) IGRA does not mandate per capita payments, nor does it prohibit state income tax on those payments, particularly when the recipients live off-reservation. To the extent the Tribe claims the tax is preempted because its Revenue Allocation Plan does not consider the members' state income tax obligations (*id.* ¶ 17), that those obligations are not considered is as irrelevant to whether IGRA exempts per capita payments from state income tax, as it is to whether Tribal members are subject to personal income tax in the first instance.

In addition, IGRA allows a tribe to make per capita payments to its members "only if" the tribe has met its other governmental obligations. 25 U.S.C. § 2710(b)(2)(B). In choosing to make per capita payments, the Tribe necessarily must have decided that its other obligations were sufficiently funded that it could distribute funds to individual members for their unrestricted use. Because the Tribe necessarily must have already met its sovereign obligations for the BIA to approve its Revenue Allocation Plan, as a matter of law, it cannot interfere with IGRA to tax the members' per capita payments.[4]

Further, California's personal income tax is imposed upon the Tribe's individual members and not the Tribe itself. There is no allegation that the Tribe pays the members' tax obligations, either directly or indirectly. Indeed, it is

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[4] The Tribe's Gaming Ordinance (TAC ¶¶ 19-20) produces the same result because it essentially replicates IGRA and the BIA regulations discussed above. Specifically, the ordinance provides the following:

> IV. Use of Gaming Revenue
>
> A. Net revenues from class II gaming shall be used only for the following purposes: to fund tribal government operations and programs; provide for the general welfare of the Tribe and its members; promote tribal economic development; donate to charitable organizations; or help fund operations of local government agencies.
>
> B. If the Tribe elects to make per capita payments to tribal members, it shall authorize such payments only upon approval of a plan submitted to the Secretary of the Interior under 25 U.S.C. [§] 2710(b)(3).

(Defs.' RJN Ex. G, Tribe's Class II Gaming Ordinance, 98-99.)

specifically alleged that the Tribe's Revenue Allocation Plan does not consider California's personal income tax on per capita payments. (TAC ¶ 17.) Thus, the members bear their own tax obligations and the tax has no effect on the Tribe.

Moreover, once the Tribe makes per capita payments, the funds are no longer Tribal funds and to tax them would not interfere with IGRA's policy objectives. (Defs.' RJN Ex. H, I.R.S. Publ'n 3908, *Gaming Tax Law and Bank Secrecy Act Issues for Indian Tribal Governments*, 2 ("Even though tribes are not subject to federal income tax, an individual tribal member not exempt from income taxation must report gross income amounts distributed or constructively received").) For instance, per capita payments are income attributable to the member for federal income tax purposes, and the Revenue Allocation Plan must include a provision notifying the member of her tax liability and detailing how the tribe will withhold the federal tax. 25 C.F.R. § 290.12(b)(4). (*See also* Defs.' RJN Ex. H at 18 ("IGRA mandates that gaming revenues are to be taken into account in computing the income tax of a member when the net gaming revenue is paid to that member as a per capita payment").) Additionally, federal courts have determined that a tribal member's per capita payment is property of her bankruptcy estate and therefore available for distribution to creditors. *See In re McDonald*, 353 B.R. 287, 291 (Bankr. D. Kan. 2006) (discussing *In re Kedrowski*, 284 B.R. 439, 451-52 (Bankr. W.D. Wis. 2002) (debtor's per capita payment from gaming revenue constitutes property of the estate)); *Johnson v. Cottonport Bank*, 259 B.R. 125, 131 (Bankr. W.D. La. 2000) (per capita payments made to tribal members that derive from net gaming revenues of tribal-owned casino are property of the bankruptcy estate). Also, courts have treated tribal members' per capita payments as individual income for purposes of ordering spousal and child support. *In re Marriage of Jacobsen*, 18 Cal. Rptr. 3d 162, 121 Cal. App. 4th 1187, 1193 (Cal. Ct. App. 2004) (upon deposit into bank account the spouse's tribal per capita payment "lost its identity as immune Indian property"); *M.S. v. O.S.*, 97 Cal. Rptr. 3d 812, 176 Cal. App. 4th

548, 553-54 (Cal. Ct. App. 2009) (tribal member's per capita payment and tribal bonuses are income for calculating child support obligation). Therefore, the Tribe remains the primary beneficiary of its gaming operation even though its members' per capita distributions are subject to taxation and other obligations.

Indeed, there is no allegation that it is impossible for the Tribe to comply with IGRA while its members pay the tax, or vice versa. *See Crosby v. Nat'l Foreign Trade Council*, 530 U.S. at 372. Nor is it alleged that imposition of the tax displaces the Tribe as the primary beneficiary of its gaming operation. *See* 25 U.S.C. § 2702(2). On the contrary, extending IGRA to preempt state tax on income remotely related to Indian gaming employment and per capita payments to members that live off-reservation stretches the statute beyond its stated purpose. Accepting the Tribe's claim would essentially extend the *McClanahan* exemption to wherever Tribal members reside, be it anywhere within California or any other state. It does not follow that in enacting IGRA, Congress intended to confer on Indian tribes an unmitigated right to enjoin the collection of state taxes on *all* tribal gaming proceeds, even those ultimately distributed to tribal members living off-reservation after the tribe has fulfilled its government obligations.

California's personal income tax does not run afoul of the Supremacy Clause because it does not interfere in a general way with the federal government's authority and policies. Accordingly, the TAC fails to state a claim for implied preemption.

C. The Tax is Valid Under the Indian Commerce Clause

The Tribe does not expressly claim that the tax is also preempted by the Indian Commerce Clause, although it did make that allegation in the previous complaint. (*Compare* SAC ¶ 29 *with* TAC ¶ 29.) Therefore, in anticipation of a potential argument by the Tribe based upon similar factual allegations made in the previous complaint, the State Defendants will demonstrate that the tax is also valid under the Indian Commerce Clause.

The Supreme Court has held that "[i]t can no longer be seriously argued that the Indian Commerce Clause, of its own force, automatically bars all state taxation of matters significantly touching the political and economic interests of the Tribes." *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. at 157. Only undue discrimination is forbidden. *Id.* Indians traveling beyond the reservation generally have been held subject to such nondiscriminatory state laws that are otherwise applicable to all citizens of the state. *Mescalero Apache Tribe v. Jones*, 411 U.S. at 148-49. The tax burden that is placed here on the Tribal members is not applied in a discriminatory manner because it applies equally to all state citizens. *See* Cal. Rev. & Tax Code §§ 17041(a), 17014(a)(1). Therefore, the tax as applied to Tribal members does not violate the Indian Commerce Clause.

D. The Tax Does not Infringe Upon Tribal Self-governance

The Tribe alleges that the tax interferes with Tribal self-governance but it makes no distinction between the tax imposed on casino wages versus per capita payments. (TAC ¶¶ 26-28.) Nonetheless, the TAC fails to state a claim for relief.

In this case, infringement upon tribal sovereignty is not an independent basis for relief. In *McClanahan* the Supreme Court concluded that the analysis of whether a state may assert jurisdiction over Indians has shifted from concepts of inherent Indian sovereignty toward federal preemption principles. *McClanahan*, 411 U.S. at 172. "The modern cases thus tend to avoid reliance on platonic notions of Indian sovereignty and to look instead to the applicable treaties and statutes which define the limits of state power[,]" although the Court cautioned the Indian sovereignty doctrine remained relevant "not because it provides a definitive resolution of the issues in this suit, but because it provides a backdrop against which the applicable treaties and federal statutes must be read." *Id.* (citations & n. omitted). In *Oklahoma Tax Comm'n v. Sac & Fox Nation*, 508 U.S. at 126, the Supreme Court recognized, citing *McClananhan*, that it must analyze relevant treaties and federal statutes against the backdrop of Indian sovereignty if tribal

members live within Indian country, otherwise it need not determine whether tribal self-governance could operate independently of its territorial jurisdiction to preempt state tax. In this case, there is no allegation that Tribal members are entitled to the *McClanahan* exemption because they live off-reservation but still within Indian country. Even if that allegation existed, the California Court of Appeal has decided the exemption would not apply. *Mike v. Franchise Tax Board*, 2010 WL 744297, at *7-8. In any event, the Supreme Court has determined that unless the Tribal members live within Indian country, this Court need not determine whether the state tax at issue here independently infringes upon tribal self-governance. Therefore, concerns for tribal sovereignty are not implicated here, and do not present an independent basis for relief.

Even if this Court finds tribal sovereignty may operate independently from federal law to preclude the state tax at issue here, which it does not, the TAC fails to state a claim for relief. The exercise of state authority may be barred if state law infringes unlawfully "on the right of reservation Indians to make their own laws and be ruled by them." *Williams v. Lee*, 358 U.S. 217, 220, 79 S. Ct. 269, 3 L. Ed. 2d 251 (1959). The Tribe has failed to allege facts demonstrating that California's tax "substantially affect its ability to offer governmental services or its ability to regulate the development of tribal resources, and that the balance of state and tribal interests renders the state's assertion of taxing authority unreasonable." *See Crow Tribe of Indians v. Montana*, 650 F.2d 1104, 1117 (9th Cir. 1981).

For the same reasons that the Tribe's preemption claim fails, the sovereignty claim also fails. (*See ante* 5-13.) Alternatively, the State Defendants address in turn each allegation in the TAC to demonstrate the Tribe has failed to state a claim that is cognizable as a matter of law, or fails to allege sufficient facts to support an otherwise cognizable legal claim.

First, the Tribe alleges that California's income tax presents the Tribe's members with "two Hobson's choices"—either they can live off-reservation and

pay the tax, or they can build housing on the Coachella or Twentynine Palms portions of the reservation to avoid the tax. (TAC ¶ 27.) According to the Tribe, the latter two choices would eliminate or significantly minimize Tribal revenue. (*Id.*) The Tribe, however, cannot blame the State Defendants for creating so-called "Hobson's choices" when the Tribe has unilaterally and voluntarily restricted its options by its decisions concerning how it will use and develop its reservation. The alleged "Hobson's choice" is an unwarranted deduction of fact and an unreasonable inference that this Court need not accept as true. *See Sprewell*, 266 F.3d at 988. In any event, that the members' choices may be limited is immaterial because the reason tribal members do not live on their membership reservation has never been relevant to a determination of whether the *McClanahan* exemption applies. *See Osage Nation v. Oklahoma ex rel. Oklahoma Tax Comm'n*, 597 F. Supp. 2d at 1262; *Jefferson v. Comm'r of Revenue*, 631 N.W. 2d at 395 n.4; *Mike v. Franchise Tax Board*, 2010 WL 744297, at *7-8.

Further, the Court need not accept as true the allegation that a decision to build housing is being forced upon the Tribe because it is contradicted by matters properly subject to judicial notice. *See Sprewell*, 266 F.3d at 988. Specifically, the allegation is belied by the Tribe's previous acknowledgment that following completion of its casino expansion project in Coachella, none of its members plan to live on the reservation, preferring to live in nearby housing instead, and that it planned to develop the Twentynine Palms parcel for residential housing, among other things. (Defs.' RJN Exs. C & D-28.)

Moreover, as discussed, the tax is paid by members that live off-reservation and has no effect on Tribal government. (*See ante* 11-13.) Even if the Tribe was somehow affected by the tax, which has not been demonstrated in this case, the Ninth Circuit and the Supreme Court have repeatedly held that "reduction of tribal revenues does not invalidate a state tax." *Gila River Indian Cmty. v. Waddell*, 91 F.3d 1232, 1239 (9th Cir. 1996) (citing cases); *Salt River Pima-Maricopa Indian*

Cmty. v. Arizona, 50 F.3d 734, 737 (9th Cir. 1995); *Crow Tribe of Indians*, 650 F.2d at 1116 ("It is clear that a state tax is not invalid merely because it erodes a tribe's revenues, even when the tax substantially impairs the tribal government's ability to sustain itself and its programs."). "It is true that tribes have an interest in their economic self-sufficiency," *Barona Band of Mission Indians v. Yee*, 528 F.3d at 1191-92 (citation omitted), but federal laws promoting tribal economic self-sufficiency are not, by themselves, sufficient to preempt state tax laws, *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 177-87, 109 S. Ct. 1698, 104 L. Ed. 2d 209 (1989). Here, the federal government requires that tribal government programs be appropriately funded and approved by the BIA before a tribe may make per capita payments. 25 C.F.R. § 290. Therefore, promoting tribal self-sufficiency does not provide a basis to preempt state tax laws.

Second, the Tribe attempts to establish that the tax occurs on the reservation by alleging it "has the potential of creating havoc in the way the Tribe uses its very limited land resources." (TAC ¶ 28(a)). According to the Tribe, if the tax is allowed to continue, its "council's activities will be consumed by addressing financial, environmental, regulatory and other issues involving construction of housing on the reservation," and the Tribe will be "forced" to reallocate or develop its unusable property. (*Id.*) To the extent this and any other allegation in Paragraph 28 is based upon "potential" harm to the Tribe, it is procedurally deficient because it fails to demonstrate that the Tribe suffered an "injury in fact" that is "concrete and particularized," and "actual or imminent, not conjectural or hypothetical." *See Lujan v. Defenders of Wildlife*, 504 U.S. at 560-61. To hold otherwise would be to disregard the Supreme Court's admonition that a state's taxing power should not be restricted on "merely theoretical conceptions of interference with the functions of government." *Oklahoma Tax Comm'n v. Texas Co*., 336 U.S. 342, 363, 69 S. Ct. 561, 93 L. Ed. 721 (1949). In any event, the Court need not accept as true the allegation that the legal incidence of the tax occurs on the reservation because it is

contradicted by other allegations in the complaint that the incidence falls on Tribal members living off-reservation (TAC ¶¶ 10, 21). *See Sprewell*, 266 F.3d at 988.

Moreover, the Tribe's gaming revenue distribution is not, as the Tribe claims, "dictated by the federal government." (TAC ¶ 28(a).) The Court need not accept this allegation as true because it is contradicted by federal regulations properly subject to judicial notice. *See Sprewell*, 266 F.3d at 988. In fact, the Tribe is not required to make per capita payments, nor is it required to have a Revenue Allocation Plan before it provides government programs like housing. 25 C.F.R. §§ 290.7-290.9. Indeed, if the tax "has a dramatic, negative impact on Tribal self-government" (TAC ¶ 28(a)), then the Tribe has not properly allocated its revenue under IGRA and the implementing regulations because per capita payments cannot be made unless the Tribe has met its other funding requirements. But this is does not appear to be the case because the BIA has approved the Tribe's Revenue Allocation Plan. (Defs.' RJN Ex. I, letter from Dep't of the Interior to Tribal Chairman (Oct. 6, 2004).)

Third, the Tribe alleges that without the tax, more money would be available for various categories "required" by the Revenue Allocation Plan. (TAC ¶ 28(b).) Again, the Court need not accept this allegation as true because it is conclusory and contradicted by federal regulations properly subject to judicial notice. *See Sprewell*, 266 F.3d at 988. The Tribe may still provide government services to its members without a Revenue Allocation Plan and without making per capita payments. 25 C.F.R. §§ 290.7-290.9. Also, because the Tribe does not pay the members' state income tax obligations, and the Tribe's Revenue Allocation Plan does not consider state income tax on per capita payments, even if the tax were not imposed, it would not result in more money to the Tribe, only more money to the members. Moreover, a reduction in Tribal revenue does not invalidate the tax. (*See ante* 16-17.) Therefore, the tax does not interfere with Tribal government services.

Fourth, the Tribe alleges that because its members must live off-reservation, it adjusts the per capita payments to include members' property taxes and sales taxes, and that sales taxes could otherwise occur on the reservation if the members lived there. (TAC ¶ 28(c).) This allegation has no bearing upon California's personal income tax on members living off-reservation. In addition, that tax-exempt sales "could" occur on the reservation inures to the benefit of Tribal members and not the Tribe, and therefore does not interfere with Tribal government.

Fifth, the Tribe claims the tax impacts Tribal sovereignty because it has a "minimal amount" of reservation land. (TAC ¶ 28(d).) The Tribe's reservation is 400 acres. The assertion that this is a "minimal amount" of land for twelve adults is conclusory and need not be accepted as true. *See Sprewell*, 266 F.3d at 988. Moreover, the impact must be substantial to constitute unlawful interference. *Crow Tribe of Indians*, 650 F.2d at 1117. This allegation fails to explain how the tax substantially affects the Tribe's ability to provide governmental services or regulate development of Tribal resources, and therefore fails to state a claim.

Sixth, the Tribe alleges that to build housing on the reservation in Coachella would require it to readjust its Revenue Allocation Plan to provide for housing construction and infrastructure; would require it to address numerous safety and environmental issues; would require it to renegotiate agreements with local government agencies that could adjust its water rights; and could interfere with its plan to build a cemetery. (TAC ¶ 28(e).) As indicated, however, the reason Tribal members do not live on the reservation is irrelevant to a determination whether the *McClanahan* exemption applies. Contrary to the Tribe's assertion, 240 acres in Coachella is not a "small amount of land" for twelve adults, particularly when the Tribe's combined reservation parcels total 400 acres. Also, the allegation that there are "spiritual and infrastructure problems associated with a cemetery" (*id.*) are conclusory and unreasonable inferences, particularly when the Tribe previously acknowledged that the reservation in Coachella is not the Tribe's ancestral lands

and has no cultural or religious significance to the Tribe. (Defs.' RJN Ex. D at 18, 19 & 36.) In addition, no Tribal members plan to live on the reservation after the Tribe completes its casino expansion project, preferring to live in nearby housing instead. (*Id.* at 28.) The suggestion that the Tribe has no place to put housing is further belied by the Tribe's application to the BIA, submitted nearly ten months before the Tribe filed this action, to acquire in trust 47.31-acres of Tribal-owned, undeveloped fee land located adjacent to the Tribe's reservation in Coachella. (Defs.' RJN Ex. E.) The Tribe requested the BIA to acquire the land in trust not for housing but to "land bank" the property for some future, unknown commercial development. (*Id.*) The Tribe had every opportunity to request the land be put in trust for housing but chose not to do so, which is consistent with previous statements that the reservation in Coachella has no cultural or religious significance to the Tribe, and that no members intend to live on that part of the reservation.

Moreover, a Revenue Allocation Plan is not required to provide for tribal housing. 25 C.F.R. § 290.9. Therefore, the tax would not require the Tribe to revise its Revenue Allocation Plan to adjust for housing. Again, the Court need not accept as true allegations that are contradicted by matters properly subject to judicial notice, or that are merely conclusory, unwarranted deductions, or unreasonable inferences. *See Sprewell*, 266 F.3d at 988.

Seventh, the Tribe alleges that its sovereignty would be infringed upon if it put housing on the reservation in Twentynine Palms because there are environmental issues and no infrastructure. (TAC ¶ 28(f).) The Tribe also claims the distance between the reservation parcels "would create barriers to economic development," and the parcels are adjacent to different local governments, which would require the Tribe to negotiate different agreements concerning "critical self-governance issues such as fire, police, utilities access, and road access." (*Id.*) The 160-acre reservation in Twentynine Palms cannot fairly be characterized as "relatively small" for twelve adults, particularly when the Tribe's combined reservation parcels

total 400 acres. The allegation that putting housing there would create a barrier to economic development is belied by the Tribe's recent plans to develop the parcel to include a second casino, hotel, RV park and *residential housing*. (Defs.' RJN Ex. B.) In addition, the land is not completely undeveloped but instead has road access (*id.* Ex. J, Draft Envtl. Assessment, Twenty-Nine Palms Casino Project (Mar. 2008) 286), and the Tribe previously contemplated agreements with local entities concerning access to police, fire, emergency, and utility services (*id.* at 147-50, 191-94, 204, 207-08.) The Court need not accept these allegations as true because they are conclusory, unreasonable inferences, and contradicted by matters properly subject to judicial notice. *See Sprewell*, 266 F.3d at 988. In any event, they fail to demonstrate how the tax substantially affects the Tribe's ability to provide governmental services or regulate development of Tribal resources, and therefore fail to state a claim.

Eighth, the Tribe alleges that California may not require the Tribe to revise its Revenue Allocation Plan, rezone its land, or dictate how and where the Tribe provides housing. (TAC ¶ 28(g).) The Court need not accept as true this unwarranted deduction of fact and unreasonable inference. *See Sprewell*, 266 F.3d at 988. California is not requiring the Tribe to take any action. Instead, by this lawsuit, the Tribe attempts to require that California apply the *McClanahan* exemption to its members wherever they reside in California, and prevent California from taxing its residents that receive the benefits and protections of its laws. But the Ninth Circuit has recognized that raising revenue to provide general government services is a legitimate state interest. *See Crow Tribe of Indians*, 650 F.2d at 1113 ("[o]f course, revenue raising to support government is a proper purpose behind most taxes"); *Salt River Pima-Maricopa Indian Cmty.*, 50 F.3d at 737 ("[t]he state also has a legitimate governmental interest in raising revenues, and that interest is likewise strongest when the tax is directed at off-reservation value and when the taxpayer is the recipient of state services"). Also, "[t]he state may tax

persons resident within its borders who do not live on reservations because it has conferred upon these persons the benefit of domicile and its accompanying privileges and advantages." *Lac Du Flambeau Band of Lake Superior Chippewa Indians v. Zeuske*, 145 F. Supp. 2d at 976.

Ninth, and last, the Tribe claims the tax disrupts its government because about one fourth of its members, or up to three adults, live out of state in part to avoid the tax, and that if exempt they "would be more eligible and able to directly take part in the Tribal government." (TAC ¶ 28(h).) There is, however, no allegation that if exempt, the members would return to California, that California residency is required to participate in essential Tribal government functions, or that the members are in fact ineligible and do not currently participate in government. This conclusory allegation does not demonstrate that the members' absence from California substantially affects the Tribe's ability to offer governmental services or regulate Tribal resources, and the Court need not accept it as true. *See Sprewell*, 266 F.3d at 988.

Accordingly, the TAC fails to state a claim that California's imposition of personal income tax on Tribal members residing off-reservation infringes on Tribal self-governance.

CONCLUSION

For the reasons stated above, the State Defendants respectfully request this Court to dismiss the TAC without leave to amend.

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Respectfully submitted,

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