An Audacious Provision In New Indian Land Lease Rules

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Law360, New York (June 24, 2013, 3:18 PM ET) -- Buried in hundreds of pages of new federal regulations governing leases of Indian lands is an audacious provision that has little to do with leasing, but quite a lot to do with state and local taxing authority.

The Bureau of Indian Affairs' new leasing regulations decree that state and local governments cannot impose taxes, assessments, fees or various other charges on non-Indians conducting activities on tribal land because the Secretary of the Interior has apparently determined that the imposition of such costs "threatens substantial tribal interests in effective tribal government, economic self-sufficiency, and territorial autonomy."[1]

The secretary's pronouncement is remarkable both because it represents a bold assertion of legislative power by an executive and because the assertion itself is inconsistent with more than fifty years of U.S. Supreme Court jurisprudence.[2] The regulation has already spawned litigation by at least one political subdivision, the Desert Water Agency in California, which estimates that it will lose $7 million a year in water service charges that it currently imposes on non-Indian lessees of land on the Agua Caliente Reservation.[3] Other attorneys have suggested that state and local taxing authorities now owe millions of dollars in refunds, arguing that the regulation is retroactive.[4]

This regulation raises a key question — can the secretary supersede decades of jurisprudence and preempt state and local taxes with a stroke of the pen? This little-discussed regulation, which could cost state and local taxing authorities many millions of dollars annually, raises fundamental questions regarding our constitutional structure and the scope of executive authority, with a great deal of money riding in the balance.

The Leasing Regulation

The new leasing regulation set forth at 25 C.F.R § 162.017 purports to preempt taxes, fees, levies, assessments and other charges in three categories: 1) permanent improvements on leased land; 2) activities conducted on leased premises; and 3) leaseholds and possessory interests of land.[5] For two of the three categories, courts have long held that many of such taxes are permissible and not a threat to tribal sovereignty and self-determination. With regard to the third, the issue appears to be unresolved.

In the context of Indian law, "preemption" does not always parallel the preemption found elsewhere in the law. Rather than asking whether there is a conflict between a federal and state law or field preemption, courts sometimes engage in a fact-specific inquiry that balances the interests of state, federal and tribal governments to assess the permissibility of a state tax on non-Indians in Indian country. Unlike taxes on Indians in Indian country (which are prohibited) or on events outside Indian country (which are permitted), there is no automatic rule that can be applied to non-Indians operating in Indian country. Nonetheless, some general principles have emerged that highlight how the new leasing regulation changes the playing field.

Subsection (a), for example, would exempt from "any fee, tax, assessment, levy, or other charge imposed by any State or political subdivision of a State" on any "permanent improvements on the leased land, without regard to ownership of those improvements." If it can be shown that there is actual federal regulation of the improvements on land that are owned by non-Indians, and that the tax interferes or conflicts with that regulation, the tax may be preempted. Case law suggests, however, that local taxation of non-Indian owned improvements is permissible.[6] More recent decisions reject the view that "[a]ny adverse effect on the tribe's finances caused by the taxation of a private party contracting with the Tribe would be ground to strike the state tax," a doctrine that the court views as "long-discarded and thoroughly repudiated."[7]

Subsection (b) would similarly exempt from taxes or other charges "activities under a lease conducted on the leased premises" by non-Indians. Yet several Supreme Court cases again hold the opposite. The court has instead counseled against allowing tribes to "sell" their tax-exemptions to non-Indians, rejecting "the proposition that 'principles of federal Indian law, whether stated in terms of preemption, tribal self-government, or otherwise, authorize Indian tribes thus to market an exemption from state taxation to persons who would normally do their business elsewhere.'"[8]

In fact, the court has uniformly upheld various taxes that subsection (b) would preempt. It has upheld laws that required both Indian and non-Indian retailers operating on reservation to collect state sales taxes on all purchases by non-Indian customers.[9] The court has also upheld business privilege taxes on non-Indians operating on reservation [10], severance taxes assessed on non-Indians engaged in oil and gas production pursuant to an Indian land lease[11], and personal property tax assessed on property owned by non-Indians and maintained on Indian land.[12] In each of these cases, the court has determined that such taxes do not interfere with tribal sovereignty and are not preempted.

Yet in explaining subsection (b), the secretary justifies the exemption by citing two cases involving the taxation of Indian traders.[13] The regulation, however, does not address a more recent Supreme Court case that upheld state regulation of traders and called into question the scope and reasoning of the decisions that the secretary cites to justify the regulation.[14] Indeed, there are a number of cases sustaining state taxation or regulation of Indian traders for taxable events on reservation.[15]

The secretary also explained that subsection (b) was appropriate because taxation has a chilling effect on a tribe's sovereign right to tax the same activity, and that dual taxation makes projects less attractive.[16] But again, it is established law that state taxation of federal employees and contractors does not infringe federal prerogatives[17], and dual taxation of non-Indians by states and tribes does not infringe on Indian sovereignty. The court has stated that "[u]nless and until Congress provides otherwise, each of the ... two sovereigns [tribe and state] has taxing jurisdiction over [certain] leases."[18] "There is no direct conflict between state and tribal schemes, since each government is free to impose its taxes without ousting the other."[19]

Subsection (c) may fare better in a legal challenge because, unlike subsections (a) and (b), it touches upon tribal property itself in a way that the first two sections do not. In those cases, the tax is clearly assessed on the non-Indian property or improvement. Subsection (c), however, purports to exempt from state and local taxes leaseholds and possessory interests in Indian lands. In many states, leasehold or possessory interest taxes are imposed in lieu of property taxes but are based on the value of the land itself.

While there is precedent for upholding state taxes on fee lands within a reservation where the land has been made alienable by Congress[20], alienable lands are not the same as trust or other lands set aside for Indians, which are uniformly understood to be exempt from state and local tax. Thus, with respect to subsection (c), the secretary may be on sounder footing in seeking to exempt from state and local tax possessory or leasehold

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interests. If the land is exempt from state taxation, then a lease of the land should not change the nature of the land by making the leasehold taxable.

Constitutional Limitations on the Secretary's Authority

A number of Supreme Court cases are plainly inconsistent with the secretary's finding that the range of state taxes covered by these regulations, in fact, interfere with tribal sovereignty and self-determination. This new regulation would send us back to a time when the court did not tolerate the intrusion of state or local jurisdiction in Indian country under any circumstances (and usually would not permit non-Indians to enter Indian country either).

But case law has evolved significantly since that time. The regulation imposes a per se rule of illegality of state taxation of non-Indians in Indian country, and the secretary suggests that such issues have been resolved by courts using a fact-intensive balancing test. But a majority of cases have upheld state taxes. As the court more recently concluded, "[a]t one time, such a tax [on non-Indian lessees] was held invalid unless expressly authorized by Congress; more recently, such taxes have been upheld unless expressly or impliedly prohibited by Congress."[21] Given that the new regulation contradicts the majority of the preemption cases, the question is: Can the secretary create a new paradigm (or adopt a very old one) without congressional authorization by promulgating a new rule?

Our constitutional structure argues against the new regulation. The United States Constitution grants Congress plenary authority over Indian affairs through the Indian Commerce Clause.[22] Under the Supremacy Clause, federal laws preempt the application of inconsistent state laws.[23] The secretary's authority is limited to the powers Congress delegates by federal legislation. Where the courts have defined the preemptive scope of the federal laws and policies that Congress has established, an executive agency cannot independently redefine that scope. Congress must instead enact new legislation that clearly expresses an intent to preempt state law.

In the end, the courts are not likely to tolerate the secretary's assertion of authority and will either circumscribe or invalidate the regulation. But it may be a costly enterprise to resolve the issue.

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[1] See Residential, Business, and Wind and Solar Resource Leases on Indian Land, 77 Fed. Reg. 72440-01, 72,447 (Dec. 5, 2012).

[2] The regulation is limited in several significant ways. First, it only applies to leases of Indian land, and does not apply, for example, to personal property taxes assessed on non-Indians of property leased to Indians on Indian land. Second, the regulation states that it does not apply to land leases that are governed by other federal statutes, including grazing permits, timber contracts and mineral leases or mineral development contracts. Third, to the extent that improvements to land or business activities conducted on Indian land are owned by Indians they are currently almost uniformly exempt from state taxation.

[3] http://www.mydesert.com/article/20130424/NEWS07/304240027/Desert-Water-Agency-sues-over-newtribal-rules?nclick_check=1

[4] http://www.mydesert.com/article/20130501/NEWS01/305010029/Experts-Tribal-tax-rule-change-big-deal

[5] The new regulation provides:
(a) Subject only to applicable Federal law, permanent improvements on the leased land, without regard to ownership of those improvements, are not subject to any fee, tax, assessment, levy, or other charge imposed by any State or political subdivision of a State. Improvements may be subject to taxation by the Indian tribe with jurisdiction.
(b) Subject only to applicable Federal law, activities under a lease conducted on the leased premises are not subject to any fee, tax, assessment, levy, or other charge (e.g., business use, privilege, public utility, excise, gross revenue taxes) imposed by any State or political subdivision of a State. Activities may be subject to taxation by the Indian tribe with jurisdiction.
(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.
25 C.F.R. § 167.017.

[6] CASES

[7] Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163,187 (1989); White Mountain Apache Tribe v. Bracker, 448 U.S. 145, 151 n. 5 (1980) ("Of course the fact that the economic burden of the tax falls on the Tribe does not, by itself, mean the tax is preempted."); Washington v. Confederated Tribes of Colville Reservation, 447 U.S. 134, 156 (1980) ("Washington does not infringe the right of reservation Indians to make their own laws and be ruled by them ***merely because the result of imposing its taxes will be to deprive the Tribes of revenues which they currently are receiving.").

[8] Department of Taxation and Fin. C. Milhelm Attea & Bros., Inc., 512 U.S. 61, 72 (1994) (citing Washington v. Confederated Tribes of the Colville Reservation, 447 U.S. 134, 155 (1980)).

[9] Moe v. Confederated Tribes of the Flathead Reservation, 425 U.S. 463 (1976); Colville, supra, 447 U.S. 134 (1980); California State Bd. of Equalization v. Chemehuevi Indian Tribe, 474 U.S. 9 (1986); Oklahoma Tax Comm. v. Citizen Band of Potawatomi Indian Tribe, 498 U.S. 505 (1991); Milhelm Attea, supra, 512 U.S. 61 (1994).

[10] Arizona Dept. of Revenue v. Blaze Construction, 526 U.S. 32 (1999).

[11] Cotton Petroleum Corp. v. New Mexico, 490 U.S. 161 (1989).

[12] Colville, supra, (motor vehicles owned by non-Indians and kept on Indian land); Thomas v. Gay, 169 U.S. 264 (1898)(cattle on Indian land pursuant to grazing leases).

[13] See 77 Fed. Reg. at 72,448 (citing Warren Trading Post Co. v. Arizona Tax Comm., 380 U.S. 685 (1965) and Central Machinery Co. V. Arizona Tax. Comm., 448 U.S. 160 (1980)).

[14] Department of Taxation and Fin. v. Milhelm Attea & Bros. Inc., 512 U.S. 61, 71 (1994) (stating that "[a]lthough language in Warren Trading Post suggests that no state regulation of Indian traders can be valid, our subsequent decisions have 'undermine[d]" that proposition").

[15] Milhelm Attea, supra; Rice v. Rehner, 463 U.S. 77 (1994); Washington v.

Confederated Tribes of Colville Reservation, 447 U.S. 134 (1980).

[16] 77 Fed. Reg. at 72,448.

[17] United States v. County of Fresno, 429 U.S. 452 (1977); United States v. New Mexico, 455 U.S. 720 (1982) (state taxation of federal contractors upheld even where United States pays the tax).

[18] Cotton Petroleum Corp. v. New Mexico, 480 U.S. at 189.

[19] Washington v. Confederated Tribes of the Colville Reservation, 447 U.S. 134, 158 (1980).

[20] See County of Yakima v. Confederated Tribes and Bands of the Yakima Nation,502 U.S. 251 (1992); Cass County, Minnesota v. Leech Lanke Band of Chippewa Indians, 524 U.S. 103 (1998).

[21] Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 173 (1989).

[22] U.S. Const. Art. I, § 8. "The Congress shall have power ...[t]o regulate commerce with foreign nations, and among the several states, and with the Indian tribes."

[23] U.S. Const. Art. VI. "This Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land: and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding."

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