Indian tribes and casinos

9th Circuit tax ruling helps chip away at tribal sovereignty

By **David H. House** and **Thomas Weathers**

Some believe there is a judicial trend of restricting Indian law tax immunities. If so, this trend may be an offshoot of recent U.S. Supreme Court decisions chipping away at tribal sovereignty, or it may be influenced by a narrow and inaccurate view of tribes as "rich casinos."

As Montanans know, thinking of tribes as "rich casinos" ignores the economic reality: Sizeable wealth generated at a small percentage of fortunately-located tribal casinos is a recent phenomenon; many Indian tribes do not have casinos, and many existing tribal casinos generate only modest income. Reducing tribes to "rich casinos" also ignores the more complex political, social and historical context: Tribes are governments that look after the welfare of their membership and the stewardship of their land, they represent multi-faceted cultures, and they maintain a unique historical place and legal status based, in part, on the history of the United States treating with tribes and recognizing tribal sovereignty.

The new Glacier Peaks Casino in Browning, Mont.

Yet in *Barona Band of Mission Indians v. Yee*, 528 F.3d 1184 (9th Cir. 2008), the 9th Circuit emphasized a tribal casino construction project's cost and the substantial revenues of the particular tribal casino in deciding that state sales taxes applied to the materials purchased for a casino expansion project on tribal lands. The court underscored "the Tribe's multi-million dollar casino expansion" and "its highly lucrative gambling enterprise," appearing to give these facts weight in its decision. *Id.* at 1186.

However, the amount of money that a building project on tribal lands costs, or will generate, are often considered irrelevant by most courts in determining whether state taxation applies, or whether a tribe is immune. Nonetheless, the *Yee* court underscored the project's costs and the casino's lucrative aspects in reaching its holding. This case's rationale and results may shape or affect future tribal immunity cases to the detriment of tribes.

Background

The Barona Band of Mission Indians operates the Barona Valley Ranch Resort & Casino on its reservation lands within San Diego County, California. In 2001, the Tribe entered a prime contract with a general contractor to expand the Casino. *Yee*, 528 F.3d at 1187. The general contractor then entered into subcontracts for various construction tasks, including a subcontract with Helix Electric Inc.

The prime contract addressed state sales taxation, setting forth a process designed to establish immunity from state sales taxes relating to the purchase of construction materials. The contract included the following terms:

- Delivery of construction materials to occur on tribal lands.
- Contractor, together with all subcontractors, designated as the Tribe's "purchasing agent" for the procurement of construction supplies.
- Purchases officially consummated, with title transferring, on the Tribe's property.
- Shipping orders and delivery receipts required to state, "THIS SALE IS NOT COMPLETE, AND TITLE DOES NOT PASS, UNTIL DELIVERY IS ACCEPTED BY THE BUYER ON THE BARONA INDIAN RESERVATION."
- Contractor not permitted to make advance payments to suppliers for materials or equipment that have not been delivered or stored at the site on tribal property.

Id. at 1187-88.

The Tribe agreed to provide indemnification from state sales tax liability provided that this process was followed.

Subsequently, Helix Electric completed approximately $4 million dollars in electrical work on the expansion project without paying state sales taxes, and thereafter the California State Board of Equalization conducted an audit and issued a Notice of Determination to Helix Electric demanding the payment of approximately $200,000 in sales and use taxes. Helix Electric looked to the general contractor for indemnification, and the general contractor sought reimbursement from the Tribe. The Tribe then sued individual members of the Board of

Equalization in their official capacities seeking a determination that the taxation was invalid.

The District Court invalidated the taxation, holding that the taxes were preempted under the balancing-of-interest test set forth in *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980).

Case analysis

The 9th Circuit reversed, upholding the state sales taxes assessed against the purchases of construction materials. *Yee*, 528 F.3d at 1186, 1193-94.

No per se immunity. The *Yee* court recognized that "'when Congress does not instruct otherwise, a State's excise tax is unenforceable if its legal incidence falls on a Tribe or its members for sales made within Indian country.'" *Id.* at 1189 (quoting *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 453 (1995)). Thus, a dispositive question was whether the legal incidence of the State's sales tax fell on the Barona Band in connection with the purchase of the construction materials.

The court reasoned that "[t]he party bearing the legal incidence of a state tax may well differ from the party bearing the economic burden of that tax." *Yee*, 528 F.3d at 1189. As such, the fact that the tax cost would ultimately be paid by the Barona Band did not mean that the tax's legal incidence, or the legal obligation to pay the tax, rested with the Tribe. The court held that the legal incidence was on the subcontractor, Helix Electric, for reasons including that under California law "'a construction contractor . . . is the 'consumer' of materials furnished later to a client pursuant to a construction contract'" and "'sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.'" Accordingly, the per se tax immunity from state sales taxation of Indian tribes in Indian country did not apply because the *Yee* court determined that the tax fell on the subcontractor rather than the Tribe.

Moreover, the court decided that the subcontractor's acting as the Tribe's "purchasing agent" by contractual arrangement was not sufficient to defeat the tax. The court stated that it declined to extend the per se test, rooted in due respect for Indian autonomy, to provide tax shelters for non-Indian businesses. The parties may not alter the economic reality of a transaction – a subcontractor performing electrical work for a general contractor – to reap a windfall at the public's expense. 'The incidence of taxation depends upon the substance of a transaction. . . . To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of . . . tax policies.'" *See Comm'r v. Court Holding Co.*, 324 U.S. 331, 334 … (1945).

The Court's inference that all tribal casinos are 'rich casinos' doesn't reflect reality, especially in Montana.

The balance of interests favored the state. The *Yee* court then employed a balancing-of-interest test to determine if the state's taxation was preempted by operation of federal law. The court explained that "[t]he test calls for careful attention to the factual setting, requiring 'a particularized inquiry into the nature of the state, federal, and tribal interests at stake, an inquiry designed to determine whether, in the specific context, the exercise of state authority would violate federal law.'" *Id.* (quoting *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 145 (1980)). The court also listed factors to aid in balancing the respective interests: "'the degree of federal regulation involved, the respective governmental interests of the tribes and states (both regulatory and revenue raising), and the provision of tribal or state services to the party the state seeks to tax.'" *Yee*, 528 F.3d at 1190 (quoting *Salt River Pima-Maricopa Indian Community v. Arizona*, 50 F.3d 734, 736 (9th Cir. 1995) (internal citation omitted).

The *Yee* court found the Tribe's interests regarding imposition of the sales tax to be weak, the federal interests similarly minimal, and "the state interest in the application of its general sales tax to be greater than the combined federal and tribal interests." *Yee*, 528 F.3d at 1192.

The court determined that the Tribe's "right of territorial autonomy is significantly compromised by the Tribe's invitation to the non-Indian subcontractor to theoretically consummate purchases on its tribal land for the sole purpose of receiving preferential tax treatment." *Yee*, 528 F.3d at 1191. The court distinguished the Barona Band case involving the purchase of construction materials from cases addressing state taxation of non-Indians performing work on Indian land.

The *Yee* court recognized the Tribe's interest in economic self-sufficiency and that, if the sales taxes were upheld, the actual cost of the taxes would be incurred by the Tribe. However, the court determined that the concern of the Tribe having to pay the tax costs "carries minimal weight in the context of a $75 million casino expansion" and because the tax cost would have been the responsibility of the non-Indian subcontractor but for the Tribe's agreement to provide indemnification for tax liability. The court also noted that the tax's legal incidence fell on the non-Indian subcontractor.

Turning to the United States, the *Yee* court reasoned that federal interests are greatest when the government comprehensively and pervasively regulates the sphere that the state is seeking to tax or regulate, and that no comprehensive or pervasive regulations were at issue in the Barona Band case. The court found that through the Indian Gaming Regulatory Act, 25 U.S.C. § 2701 et seq. (IGRA), the federal government regulates Indian gaming and that the state's tax "is not on Indian gaming activity or profits, but rather on construction materials purchased by a non-Indian electrical subcontractor, which could be used for a multitude of purposes unrelated to gaming."

The court recognized the federal interest in tribal economic self-sufficiency, but found that interest fades "when the commercial activity is rigged to trigger a tax exemption." The court also repeated that the concern relating to "self-sufficiency necessarily lessens in the specific context of a multi-million dollar casino expansion."

Looking to the state, the *Yee* court ruled that the balancing of interests tips in its favor "where the state levies a neutral sales tax on non-Indians' purchases which – but for contractual creativity – would have occurred on non-Indian land." The court found that the state has a legitimate interest in raising revenue to provide general governmental services. (The court did note that the state interest is strengthened where a nexus exists between the taxed activity and the provided government function, and the court acknowledged that there was not such a connection.)

The *Yee* court also found that the state has an interest "in preventing the manipulation of its tax laws to aid a casino in shopping tax exemptions to local businesses who otherwise would remit sorely needed revenue to the state."

The Indian Gaming Regulatory Act did not preempt the taxation. The Tribe separately argued that the IGRA alone preempted the state taxation. The court disagreed, finding that the IGRA's comprehensive regulation of Indian gaming does not extend to third-party purchases of construction materials for gaming facilities. The court also found that the balancing-of-interest test developed in *Bracker* was the appropriate analytical framework to determine whether the sales taxes were preempted by operation of federal law.

Discussion

The *Yee* court described the contractual arrangement regarding the state sales taxation as an effort by the Tribe to "merely market[ ] a sales tax exemption to non-Indians as part of a calculated business strategy" and as a "strategic effort to receive construction services from non-Indians at a competitive discount by circumventing the state sales tax. . . ." Words like "calculated" and "circumventing" indicate disapproval. A contrary perspective would be that the Tribe merely attempted to diligently exercise its sovereign rights relating to a tribally-funded project on tribal lands.

The *Yee* court's application of the *Bracker* balancing-of-interest test raises points for consideration:

First, the outcome of the legal incidence test informs a court as to which legal analysis to apply (i.e., per se or balancing test), but should not favor a state when the interests are then balanced. However, the *Yee* court appeared to count the fact that the tax's legal incidence fell on the non-Indian subcontractor as weakening the tribal interest. As a balancing test inherently applies only when the legal incidence of a tax does not fall on a tribe, it is surprising the court also balanced this factor against the Tribe.

Second, there is, generally speaking, nothing unusual about off-reservation vendors making sales on a reservation and state taxes not applying. As an example, the Supreme Court held that a state tax did not apply to an on-reservation sale of farm machinery to a tribal enterprise by a corporation that did not reside on the reservation because the taxation was preempted by the Indian trader statutes. *Central Machinery Company v. Arizona State Tax Commission*, 448 U.S. 160 (1980). However, in finding weak tribal interests, the *Yee* court disparaged the contractual arrangement for the construction material purchases.

Third, the court stated that the concern with respect to "self-sufficiency necessarily lessens in the specific context of a multi-million dollar casino expansion." However, in *California v. Cabazon Band of Mission Indians*, 480 U.S. 202 (1987), the Supreme Court found a tribal interest in economic self-sufficiency relating to a tribal casino operation. *Id.* at 218-19.

Fourth, the *Yee* court favorably discussed *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134 (1980), for the proposition that tribes may not simply market tax exemptions for business advantage. *Yee*, 528 F.3d at 1190-91. However, the Colville issue was whether a state should be able to tax the sale of cigarettes by tribal smoke shops to non-Indians. In contrast, in the Barona Band's situation the question was whether the sales taxes, or the costs of the sales taxes, would be paid by the Tribe. (Even though the legal incidence was found to be on Helix Electric, the state's sales tax in the construction context is an upstream tax that would probably be passed on to the Tribe as a business matter, irrespective of whether an indemnification agreement was in place.)

Fifth, the *Yee* court stated that "IGRA is a gambling regulation statute, not a code governing construction contractors, the legalities of which are of paramount state and local concern." However, the court did not acknowledge that the locality with arguably the greatest interest in the legalities and governance of construction contractors is the Barona Band, which governs the land on which the casino is located and operates the casino.

Sixth, it can be noted that a state's general interest in raising revenue may not be enough to defeat tribal and federal interests, depending on the circumstances. The *Yee* court found that the state has a legitimate interest in raising revenue to provide general governmental services and this factor was important to its decision. *Id.* at 1192-93. However, elsewhere the Supreme Court and the 9th Circuit have held that a state's gen-

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eral interest in raising revenue, alone, may not be sufficient to outweigh tribal and federal interests. *See, White Mountain Apache Tribe*, 448 U.S. at 150; *Hoopa Valley Tribe v. Nevins*, 881 F.2d 657, 661 (9th Cir. 1989).

Conclusion

The *Yee* court described the tribal casino as a sophisticated, multi-million dollar enterprise. This factor appears to have influenced the court's holding that the sales taxes applied. The court viewed the relative interest in tribal self-sufficiency as minimal, evidently because the casino is lucrative. In future cases, accordingly, the economic circumstances of a tribal enterprise may influence a court's disposition. Possibly, the *Yee* court's rationale will be applied more broadly than the factual circumstances of a successful tribal casino.

Based on the *Yee* decision, a reasonable conclusion may be that federal courts will increasingly interpret and apply tax immunities more narrowly. Contractual arrangements that formerly achieved tribal sales tax immunity will possibly not result in similar tax immunity going forward, at least in certain circumstances.

A few observations geared toward a tribal perspective:

■ Tribes should carefully consider whether to offer indemnification of third-party contractors, suppliers, or retailers in the event sales taxes are imposed. In *Yee*, the court denied the tax immunity in spite of the fact that the Tribe would ultimately pay the tax cost based on the indemnification agreement.

■ Sales and purchase arrangements meant to meet tax immunity requirements

A self-help law program is NOT a bad idea

In February 2009, I walked into the Missoula Self-Help Center not knowing what to expect. I did know that I was a single mother who had already spent what little I had in savings on an attorney who had helped me with family law the previous year

I went to the Self-Help Center desperate for aid. As I opened the doors, six other people were already in line ahead of me, and there were many who came in after. I immediately saw people who were in even more dire situations than I. People who were desperate for help waited with me for someone to help them muddle through the legal jargon and piles of paperwork.

When my turn came, I was greeted with a friendly smile and a genuine concern about my situation. The staff pointed me in the right direction, and attorneys who volunteered there helped me complete the appropriate paperwork. I cannot express how much this program helped me in a time when I had nowhere else to turn.

I read a comment in July's *Montana Lawyer* stating that people who can afford a private attorney will take advantage of a self-help center. This may be true, but so it goes with every other social aid program including unemployment, welfare, Medicaid, etc. Let's not throw the baby out with the bath water; just because few may do so, doesn't mean that it should affect the many who truly need a program like this.

The people who I saw in the waiting area, like myself, were obviously desperate and did not have the means to attain private legal counsel. Maybe if more attorneys would take pro bono cases, there would not be a need for a self-help program, but clearly this is not that case. I urge everyone to support programs like these. Those who cannot afford an attorney are perhaps those most in need of one.

– Stacie Johnston,
occupational licensing examiner
State of Alaska

should be directly and clearly within the scope of the applicable immunity. In *Yee*, the court rejected the Tribe's arrangement of designating the contractor and subcontractors as "purchasing agents," stating that the contracting parties may not change the economic reality of a transaction in order to alter the tax liabilities.

■ An approach that may bolster a tribe's per se immunity position is for the tribe itself to negotiate, purchase, and take delivery of construction materials on its reservation or trust land.

Particular situations relating to state taxation and the immunity of an Indian tribe or tribal entity should be considered in light of the specific facts, circumstances, and laws at issue. In doing so, it is appropriate to reflect on the trends in this area of the law represented, in part, by the sales taxation that the Yee court permitted with respect to the construction work at the Barona Band's casino.

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THOMAS WEATHERS *is Aleut and a founding partner of Alexander, Berkey, Williams & Weathers. Mr. Weathers' primary focus is in the areas of tribal business matters, gaming, and the Indian Child Welfare Act. Mr. Weathers is also a past president of the National Native American Bar Association. They can be reached by accessing the firm's website – www.abwwlaw.com.*

News About Members

Chris Fagan recently joined the Sullivan, Tabaracci & Rhoades law firm in Missoula as an associate attorney specializing in real estate and general litigation. Mr. Fagan completed his undergraduate studies in history and geography in 2000 at the University of Nevada, Reno. He earned his JD in 2004 from the University of Montana, and has lived and practiced in Missoula since then. He gained experience in conservation land transactions and easement negotiations with a local non-profit organization before returning to Sullivan, Tabaracci & Rhoades. Mr. Fagan also serves on the Council for Montana Trout Unlimited.

The Billings law firm of Halverson & Gilbert announced the association of **Katherine S. Huso** and **Jameson C. Walker**.

Ms. Huso graduated from the University of Montana School of Law in 2007. She was a member of the NALSA Moot Court Team. Prior to joining the firm, she was an associate at Corette, Pohlman & Kebe in Butte for two years. Ms. Huso's primary areas of practice will be civil litigation and insurance defense.

Mr. Walker recently graduated from the University of Montana School of Law in 2009. He was the Student Bar Association president, the American Bar Association Law Student Division 12th Circuit governor, a member of the Trial Team, and the recipient of the 2009 Dean's Award. Mr. Walker will practice in the areas of civil litigation and insurance defense.

Hanna Warhank has joinged the Great Falls law firm of Church, Harris, Johnson & Williams as an associate attorney. Ms. Warhank is a member of the firm's tax and transactional practice group, with an emphasis on business and estate planning, taxation, estate administration, and real property. She grew up in the small, Hi-Line town of Rudyard, Mont. She attended Carroll College in Helena and graduated with a BA in Accounting and Political Science. She continued on to the University of Montana School of Law and earned her juris doctor in May 2009.

The Crowley Fleck law firm has announced that six new associates have joined the firm. They are:

■ **Kelsey E. Bunkers**. Ms. Bunkers graduated magna cum laude from Creighton University School of Law in 2007,