

August 12, 2013

Practice Group(s):

Tax

Indian Law (North America)

Ninth Circuit Decision Creates New Tax Opportunities and Challenges for Activities on Indian Trust Lands¹

By Elizabeth C. Crouse, Bart J. Freedman and Kari L. Vander Stoep

Since the Supreme Court's 1973 decision in Mescalero Apache Tribe v. Jones,² it has been clear that state and local tax authorities could not assess property tax on permanent improvements located on tribal trust land when those improvements are owned by an Indian tribe directly or indirectly through a corporation incorporated under Section 17 of the Indian Reorganization Act (the "IRA").³ Although the Mescalero decision could be interpreted as extending to all permanent improvements on tribal trust land regardless of form of ownership, other forms of ownership such as tribal ownership through a limited liability company ("LLC") had not yet been tested in court. In its recent decision in Confederated Tribes of the Chehalis Reservation v. Thurston County Board of Equalization,⁴ the Ninth Circuit held that the prohibition extends to permanent improvements owned by an LLC that is in turn majority-owned by a tribe.

The Chehalis decision concerns an assessment of county property tax on permanent improvements -- a resort -- situated on tribal trust land in Thurston County, Washington. The resort, the Great Wolf Lodge, was owned by CTGW, LLC, a Delaware limited liability company. The Confederated Tribes of the Chehalis Reservation (the "Tribe") owned 51% of CTGW and the other 49% was owned by Great Wolf Resorts, Inc., a Delaware corporation that was publicly traded during the years at issue in the decision. Prior to building Great Wolf Lodge on trust land, CTGW obtained an opinion from the State of Washington's Department of Revenue in which the Department determined that the lodge would not be subject to county property tax.⁵ Nonetheless, Thurston County assessed the tax. In the Chehalis decision, the Ninth Circuit held that the county could not assess its property tax on the Great Wolf Lodge.

The Ninth Circuit's decision is significant for several reasons.

1. **The Chehalis decision could provide an opportunity for tax-incentivized investment by non-Indians in Indian Country.** The court's interpretation of the Mescalero decision broadens the types of ownership entities for which courts will bar state and local property taxation on permanent improvements on tribal trust land. In Mescalero, the Supreme Court

¹ Indian trust lands, sometimes also known as Indian country, includes all land held by the federal government in trust for Indian individuals and tribes. This includes reservations, trust land outside of reservations, allotments, and dependent Indian communities.

² 411 U.S. 145, 157 n.13 (1973).

³ 25 U.S.C. § 477.

⁴ No. 10-35642 (9th Cir. July 30, 2013).

⁵ Appellants' Opening Brief, No. 10-35642, p. 3.

Ninth Circuit Decision Creates New Tax Opportunities and Challenges for Activities on Indian Trust Lands

indicated that the Mescalero Apache Tribe either owned the improvements at issue directly or through a corporation incorporated under Section 17 of the IRA, an entity that is typically viewed as indistinguishable from a tribe for tax purposes. However, in Chehalis, the permanent improvements were owned by an LLC, only 51% of which was owned by the Tribe.

We note, however, that the court's decision does not resolve the extent of the bar on state and local property taxes on permanent improvements on tribal trust lands. Chehalis clearly bars assessments of state or local property tax on permanent improvements on trust land that an entity owns, so long as a tribe owns 51% of that entity. Chehalis could also be interpreted, however, as supporting an exemption from property tax for permanent improvements on trust land where *any* percentage of the improvement is owned, directly or indirectly, by a tribe. Furthermore, the court's reasoning could support extending the exemption to *all* permanent improvements on trust land, regardless of whether a tribe has any ownership interest in those improvements. Those conclusions arise from the court's statement that "Mescalero sets forth the simple rule that [25 U.S.C.] § 465 preempts state and local taxes on permanent improvements built on non-reservation land owned by the United States and held in trust for an Indian tribe. This is true without regard to the ownership of the improvements."⁶

2. **Property tax authorities now must look behind a state-chartered entity that owns improvements on trust land.** Because the Chehalis decision clearly exempts from property tax permanent improvements that are owned by entities that are at least 51% owned by a tribe, property tax authorities must either not tax any permanent improvements on tribal trust land or confirm that the deeded owner is not itself 51% owned by an Indian tribe. To do so, the tax authority must break with typical practice and look behind entities that own permanent improvements on trust land.

3. **Recently released Bureau of Indian Affairs regulations barring various types of taxation of leases and leasehold property in Indian Country were not a determining factor in the court's decision and will continue to be of interest.** In December of 2012, the Bureau of Indian Affairs (the "BIA") released new regulations for leases in Indian Country. "Subject only to applicable federal law," the regulations bar state and local governments from collecting taxes from non-Indians leasing tribal trust lands. The regulations prohibit state and local governments from taxing permanent improvements on leased trust land, activities under a lease, and the leasehold or possessory interest. The regulations explicitly prohibit the imposition of "business use, privilege, public utility, excise, and gross revenue taxes" on the activities of non-Indian lessees on tribal trust lands. The scope of that prohibition has not been clarified, but it arguably encompasses income and sales taxes.⁷ In a footnote in the Chehalis decision, the Ninth Circuit declined to construe the new regulations or consider their

⁶ No. 10-35642, p. 14 (emphasis added).

⁷ In Chehalis, the Ninth Circuit did not suggest that its decision could justify an exemption from sales taxes. To the contrary, the court cited and relied upon cases such as *Salt River Pima-Maricopa Indian Cmty. v. Arizona*, 50 F.3d 734, 738 (9th Cir. 1995) (holding that federal law did not preempt sales taxes on sales to non-Indians). The Chehalis decision did not displace the balancing test from White Mountain Apache Tribe v. Bracker, 448 U.S. 136 (1980), that applies to non-real property taxation issues. Rather, the court in Chehalis held that 25 U.S.C. § 465, which states that land taken into trust by the United States for an Indian tribe or individual Indian "shall be exempt from State and local taxation," also bars the taxation of permanent improvements on such tribal trust lands.

Ninth Circuit Decision Creates New Tax Opportunities and Challenges for Activities on Indian Trust Lands

effect on the Great Wolf Lodge. The court concluded that, for purposes of the case before the court, the “regulation ‘merely clarifies and confirms’” the holding in Mescalero barring state and local taxation of permanent improvements on tribal trust lands.⁸ The BIA’s new regulation faces other legal challenges, however. For example, litigation is ongoing in California that directly challenges the BIA’s new regulations as they relate to the Desert Water Agency’s imposition of property taxes, water service charges, and groundwater replenishment assessments on non-Indian lessees on the Agua Caliente Indian Reservation.⁹

Although the extent of its application is somewhat unclear, the Chehalis decision presents opportunities for tribes and investors in Indian Country and challenges for state and local property tax authorities. To discuss how the Chehalis decision may affect you or your organization, we invite you to contact one of the K&L Gates LLP attorneys listed below.

U.S. Treasury Department Circular 230 Notice: To ensure compliance with requirements imposed by the U.S. Treasury Department, any U.S. federal tax advice contained in this communication, including any attachments, is limited in scope to the topics discussed and is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code; or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed in this communication.

Authors:

Elizabeth C. Crouse

elizabeth.crouse@klgates.com

+1.206.370.6793

Bart J. Freedman

bart.freedman@klgates.com

+1.206.370.7655

Kari L. Vander Stoep

kari.vanderstoep@klgates.com

+1.206.370.7804

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt
Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Moscow Newark New York Orange County Palo Alto Paris
Perth Pittsburgh Portland Raleigh Research Triangle Park San Diego San Francisco São Paulo Seattle Seoul Shanghai Singapore Spokane
Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates practices out of 48 fully integrated offices located in the United States, Asia, Australia, Europe, the Middle East and South America and represents leading global corporations, growth and middle-market companies,

⁸ No. 10-35642, p. 10 n.6.

⁹ Desert Water Agency v. U.S. Dep’t. of Interior, Case No. 5:13-cv-00606-DMG-OP (C.D. Cal.).

Ninth Circuit Decision Creates New Tax Opportunities and Challenges for Activities on Indian Trust Lands

capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2013 K&L Gates LLP. All Rights Reserved.