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Tax Developments Provide Opportunities for Economic Growth in Indian Country

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OVERVIEW OF PRESENTATION

- Background on Federal Indian Law
- 2013 BIA Leasing Regulation – 25 C.F.R. § 162.017 and Related Cases
- Treaty Right to Travel: *Cougar Den*
- Real World Opportunities for Investment in Indian Country
- Opportunity Zones in Indian Country

BACKGROUND ON FEDERAL INDIAN LAW

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- Sovereign Immunity
- Treaty Rights
- Tribal Taxation of non-Indians: *Merrion* and *Montana*
- State and local taxation of non-Indians in Indian Country: *Bracker*

SOVEREIGN IMMUNITY

- Native American Indian tribes are sovereign entities.
- A tribe/tribal entity can only be sued if it clearly and expressly waives its sovereign immunity.
- Tribes can waive their sovereign immunity, but only if they do so clearly, expressly, and unequivocally.

TREATY RIGHTS

- Adjudicated treaty rights include:
  - Right to fish;
  - Right to hunt; and
  - Right to travel.
- Treaties are construed as the Indians would have understood them at the time they were negotiated and signed.
- Treaties between the United States and Indian tribes are the supreme law of the land.

TRIBAL TAXATION OF NON-INDIANS

- *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982)
  - "The Power to tax is an essential attribute of Indian sovereignty because it is a necessary instrument of self-government and territorial management."
  - Upholding tribal severance tax on non-Indian lessees who produced oil and gas on the tribe's reservation under leases approved by the Secretary of Interior.

TRIBAL TAXATION OF NON-INDIANS

- *Montana v. United States*, 450 U.S. 544 (1981)
  - A tribe has jurisdiction over a non-Indian when:
    - (1) there is consent through a consensual relationship; and/or
    - (2) the non-Indian's conduct threatens the political integrity, health, or welfare of the tribe.
  - There must be a nexus between a tribe's assertion of jurisdiction and the non-Indian activity/conduct in question.
  - Holding Crow Nation could not regulate nonmember hunting and fishing on fee land on the reservation.
- Address tribal jurisdiction via contract if possible.

STATE AND LOCAL TAXATION IN INDIAN COUNTRY

- *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980)
  - Established what is commonly known as the *Bracker* balancing test.
  - Under *Bracker*, State and local jurisdiction over non-Indians conducting business in Indian country is subject to a balancing inquiry.
  - Courts weigh state and local interests against federal and tribal interests.
  - Arizona could not apply its motor carrier license and use fuel taxes to a non-Indian logging company operating on tribal and BIA roads.

BRACKER BALANCING INQUIRY

- *Bracker* analysis turns on a number of factors:
  - The status of the land (trust, allotted, fee).
  - The degree of federal regulation and control and the interests that regulation/control seeks to promote.
  - The characterization of the state/local tax—interferes with or complements federal/tribal interests.
  - The legal incidence of the tax—the tribe or non-Indians.
  - The nature of the activity/operations being taxed, including the involvement of Indians in the activity/operations.
  - The degree to which the taxing entity provides services associated with the taxed activity/operations.
  - The regulatory and revenue raising interests of states and tribes.

2013 BIA LEASING REGULATIONS

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- An “Indian tribe with jurisdiction” may assess taxes on lessees of Indian trust lands.
- “Subject only to applicable Federal law,” state and local governments may not assess taxes on lessees of Indian trust lands.
- When BIA enacted the regulations, it was not clear how courts would interpret the “subject only to applicable Federal law” proviso.

2013 BIA LEASING REGULATIONS

- Address taxes, fees, assessments, levies, and charges on the following:
  - Permanent improvements on trust lands.
  - Activities of lessees of trust lands.
    - Business use, privilege, public utility, excise, and gross revenue taxes specifically identified in the regulations.
  - Leasehold or possessory interests.
    - The value of the leasehold or possessory interest held by the non-Indian lessee minus the lessor’s retained rights in the property and/or any other rights that will revert back to the owner at the end of the lease or possession.

2013 BIA LEASING REGULATIONS

- In the preamble to the rules, the Secretary conducted a *Bracker*-like analysis:
  - Listed the federal regulations that "occupy and preempt the field of Indian leasing."
  - Analyzed the federal and tribal interests and policies at stake in leasing trust lands.
  - A tribe's ability "to convey an interest in trust or restricted land arises under Federal law, not state law and Federal legislation has left the state with no duties or responsibilities for such interest."
  - State taxation undermines federal interest with respect to Indian land leases.

JUDICIAL INTERPRETATION OF THE 2013 BIA LEASING REGULATIONS

- Federal courts in the Ninth and Eleventh Circuits have considered the new regulations in evaluating taxes on permanent improvements, possessory interest taxes, rental taxes, utility taxes, and water agency charges.
- They have evaluated the new regulations as part of the *Bracker* analysis, i.e., “as applicable Federal law”, and not a separate reason to invalidate the taxes in question.
- Courts have looked at the regulations under the federal interests prong of the *Bracker* inquiry.

NINTH CIRCUIT

- *Desert Water Agency v. U.S. Dep't of Interior*, 849 F3d 1250 (9th Cir. 2017)
  - Water agency charges on non-Indian lessees of trust land not preempted by new regulations.
- *Agua Caliente Band of Cahuilla Indians v. Riverside County*, 2017 WL 4533698 (C.D. Cal. June 15, 2017)
  - County possessory interest tax on non-Indian lessees of trust and allotted lands not preempted under new regulations.

ELEVENTH CIRCUIT

- *Seminole Tribe of Florida v. State of Florida*, 799 F.3d 1324 (11th Cir. 2015)
  - Rental tax on non-Indian lessees preempted
  - Utility tax on tribe not preempted

Desert Water Agency v. U.S. Dep’t of Interior, 849 F3d 1250 (9th Cir. 2017):

Water agency charges on non-Indian lessees of trust land not preempted by new regulations.

DESERT WATER AGENCY FACTS

- Desert Water Agency (DWA), a political subdivision of the state of California, provides water services to non-Indian lessees on the Agua Caliente Indian Reservation.
- Non-Indian lessees build and operate homes, hotels, restaurants, and stores on the reservation.
- DWA charges a variety of fees and taxes on the non-Indian lessees for its services.

DESERT WATER AGENCY DECISION

- DWA challenged the new regulations arguing that they illegally preempted its charges.
- The Ninth Circuit held that the new regulations do not change existing law, i.e., *Bracker* remains good law.
- Courts still have to conduct a *Bracker* analysis in each specific case to determine whether the taxes, fees, charges, etc. imposed by a local or state government are preempted.
- The Ninth Circuit dismissed DWA's lawsuit.

DESERT WATER AGENCY – INTERIOR'S POSITION

- Interior agreed with the Court's interpretation.
- "The only thing § 162.017 does, according to Interior, is to state publicly the agency's interpretation of existing law (namely, *Bracker*), and to clarify its opinion that under *Bracker*, the federal and tribal interests at stake are strong enough to have a preemption effect in the generality of cases. But on the ultimate question of whether any specific state tax or charge is preempted under *Bracker*, Interior is agnostic; courts must answer such questions in the same way they always have, by applying the *Bracker* test de novo."

Agua Caliente Band of Cahuilla Indians v. Riverside County, 2017 WL 4533698 (C.D. Cal. June 15, 2017):

County possessory interest tax on non-Indian lessees of trust and allotted lands not preempted under new regulations.

AGUA CALIENTE FACTS

- Agua Caliente Band leases trust and allotted lands to non-Indians for commercial and residential development, including permanent improvements.
- Riverside County assesses a 1% possessory interest tax (PIT) on the "full cash value" of a lessee's interest in the leased property.
- The County assesses the PIT on the non-Indian lessees as a "general revenue" tax.
- To avoid double taxation issues, the tribe does not impose its own PIT on the non-Indian lessees.

AGUA CALIENTE DECISION

- The court first held that the PIT was not preempted by § 465 because the lands were not taken into trust under the Indian Reorganization Act or the Act of July 28, 1955.
- The court next conducted a *Bracker* analysis looking at the federal, tribal, and state interests at stake and held the PIT was also not preempted under *Bracker*.

AGUA CALIENTE – *BRACKER* ANALYSIS

- Federal interest:
  - Federal regulation of Indian lands leasing is comprehensive and pervasive.
  - Among other things, BIA approves leases with third parties, with over a dozen federal statutes that govern the process.
  - Federal interests are great and "pervasive enough to preclude the burdens of a tax, absent sufficient state interests."

AGUA CALIENTE – *BRACKER* ANALYSIS

- Tribal interest:
  - Raising revenue for the tribe's economic well-being and tribal sovereignty and self-sufficiency.
  - The PIT may increase project costs for lessees, thereby impeding the tribe's ability to attract non-Indian investment and decreasing funds available to the tribe for economic development.
  - Tribe submitted no evidence it could provide the services offered by the state and local governments.
  - The tribe could impose a PIT tax if it chose to do so, but most of the lessees are on allotted lands, which the court appeared to assume the tribe would not be able to tax.

AGUA CALIENTE – *BRACKER* ANALYSIS

- State interests:
  - The County and DWA provide numerous services on the reservation that are funded by the PIT, including public road maintenance, animal and pest control services, public safety, law enforcement, and education.
  - These services are "intimately" related to the non-Indian lessees use and enjoyment of the leased Indian lands.
  - "[T]he PIT here helps fund the very state services from which its payers benefit."
  - "[T]he state interest in raising revenues here is at its strongest because, by and large, the taxpayer is the recipient of state services."

AGUA CALIENTE DECISION

- State interests outweigh federal and tribal interests:
  - "[T]he Court concludes that the PIT's adverse effect on the Tribe is simply too indirect and too insubstantial to support Agua Caliente's claim of preemption."
  - The court focused on what it described as the "dispositive question" – the legal incidence of the tax: "Here, it is undisputed that the legal incidence of the tax falls on non-Indians."
  - "[T]he PIT strikes the right balance. While it may minimally affect the Tribe's revenue generation, it does not affect the Tribe's ability to self-govern. Nor does it appear to interfere at all with the Tribe's leasing process."
  - "[T]he governmental services that the PIT helps fund promote the very activity being taxed—the enjoyment and use of Trust Land by non-Indian lessees and Tribe members alike."

Seminole Tribe of Florida v. State of Florida, 799 F.3d 1324 (11th Cir. 2015):

Rental tax on non-Indian lessees preempted;

Utility tax applied to utility company not preempted.

SEMINOLE TRIBE OF FLORIDA FACTS

- Non-Indian corporations operated food courts at tribal casinos under leases approved by the Secretary of Interior.
- Florida assesses a rental tax on the privilege of engaging in the business of, among other things, leasing real property in the state.
- Landlord collects and remits the tax, which constitutes a lien on the lessee's personal property, as opposed to the real property.
- Florida assessed the rental tax on the non-Indian food-court operators.

SEMINOLE TRIBE OF FLORIDA FACTS

- Florida applies a utility tax on a utility company's gross receipts from its retail customer services in the state.
- Tax is imposed on the utility company, not the consumer, though the utility company can pass the tax on to the consumer.
- Florida assessed the utility tax on the utility company, which could pass it along to the end user.

SEMINOLE TRIBE OF FLORIDA – RENTAL TAX

- Eleventh Circuit held that the rental tax was preempted by federal law.
- It was preempted by 25 U.S.C. § 465 (now 25 U.S.C. § 5108) because it was an impermissible tax on the land.
- It was also preempted under *Bracker* because of the pervasive federal scheme for regulation of Indian land leasing.

SEMINOLE TRIBE OF FLORIDA – RENTAL TAX

- Court would not defer to the BIA's regulations, but would consider them as part of the *Bracker* analysis.
- *Bracker* requires a particularized, case-specific analysis of the state, federal, and tribal interests at stake.
- When enacting the rules, the Secretary "did not examine Florida's interest in imposing the particular" taxes in this specific case.

SEMINOLE TRIBE OF FLORIDA – RENTAL TAX

- "Federal statutes, regulations, and even the analysis conducted by the Secretary's Preamble demonstrate the pervasive and comprehensive federal regulation of the leasing of Indian land."
- State's only interest in assessing the tax was to raise general revenue for generalized services.
- State tax not designed to compensate the state for any state services or regulations related to leasing trust lands.
- The "pervasive federal scheme for regulating Indian land leasing preempts Florida's" rental tax.

SEMINOLE TRIBE OF FLORIDA – UTILITY TAX

- The legal incidence of the tax falls on the non-Indian utility company providing services to the reservation.
- Court found no pervasive federal interest or comprehensive regulatory scheme for on-reservation utility delivery and use that would preempt state taxation of a utility provider's receipts derived from on-reservation utility service.

SEMINOLE TRIBE OF FLORIDA – UTILITY TAX

- Tribe argued that electricity is essential to all on-reservation activities, including land leasing, and thus it should be preempted under *Bracker*.
- The court found that the Tribe's interpretation ignores the particularized inquiry required by *Bracker*.
- There is no evidence of a substantial federal interest in regulating utility service and use on the reservation.
- FN 22: "If properly framed, the Tribe may be able to demonstrate that the Utility Tax is preempted with respect to," among other things, land leasing.

TAKEAWAYS ON NEW REGULATIONS

- *Bracker* remains controlling law for analyzing state/local taxes on non-Indian lessees of reservation land.
- "Subject only to applicable federal law" is a reference to *Bracker.*
- Preamble to the regulations layout a comprehensive federal scheme for Indian land leasing.
- Framing the issue is key, e.g., a tax's specific v. general purposes.
- "Indian tribe with jurisdiction" may be a reference to *Merrion* and *Montana*.

TREATY RIGHT TO TRAVEL: *COUGAR DEN*

CASE STUDY: *COUGAR DEN*

- SCOTUS held that Yakama Treaty preempted Washington tax. *Washington State Department of Licensing v. Cougar Den, Inc.*, ___586 U.S. ___, 2019 WL 1245535, at *2 (Mar. 19, 2019).
- Notable for two reasons:
  - Potential new advocate for tribal rights on the Court: Justice Gorsuch.
  - Decision could open door to on-reservation economic growth and development opportunities, at least for tribe's with similar "right to travel" treaty provisions.

COUGAR DEN, INC.

- Fuel company owned by a member of the Yakama Nation and incorporated under tribal law.
- Buys fuel in Oregon, transports it to the Yakama Reservation via a public highway in the state of Washington, and then sells it to tribal businesses on the reservation.
- From March to October 2013, Cougar Den transported more than five million gallons of fuel through Washington to the Yakama Reservation.

WASHINGTON STATE FUEL TAX

- Washington imposes a fuel tax when fuel is removed from the terminal rack or imported into the state (Chapter 82.38 RCW).
- The tax is not on the possession or importation of fuel, but on its transportation.
- The fuel tax generates over $1.5 billion each year for the state.

DISPUTE

- Cougar Den did not pay taxes on the fuel it imported.
- In December 2013, the Washington State Department of Licensing assessed Cougar Den with $3.6 million in unpaid taxes, penalties, and licensing fees for transporting the fuel from Oregon into Washington.

TREATY RIGHTS

- Cougar Den argued that a clause in the 1855 treaty between the United States and the Yakama Nation preempts Washington's fuel tax.
- Cougar Den relied on the "right to travel" provision, which reserves for tribal members "the right, in common with citizens of the United States, to travel upon all public highways."

PROCEDURAL HISTORY

- The Yakima County Superior Court ruled that the fuel tax violated the tribe's right to travel guaranteed by the 1855 treaty.
- Washington sought direct review with the Washington Supreme Court, which also ruled in Cougar Den's favor.
- Washington then appealed to the U.S. Supreme Court, which granted review.

SCOTUS DECISION

- In a 5-4 decision, the Court held that the Yakama treaty prohibits the state of Washington from imposing its fuel import tax on Cougar Den.

MAJORITY OPINION

- The court concluded that the Yakama understood the treaty right to travel as including "the right to travel with goods for purposes of trade" and that "to impose a tax upon traveling with certain goods burdens that travel."

- Justice Breyer explained that the tax applies to Cougar Den "only because [it] happen[s] to transport goods on a highway while en route to [the] reservation. And it is the practical effect of the state law that we have said makes the difference."

GORSUCH CONCURRENCE

- Justice Gorsuch, in a concurrence joined by Justice Ginsberg, took a more straightforward approach, stating that the Court's only "job in this case is to interpret the treaty as the Yakamas originally understood it in 1855—not in light of new lawyerly glosses conjured up for litigation a continent away and more than 150 years after the fact."
- He concluded that the state tax "is about taxing a good as it passes to and from market—exactly what the treaty forbids."
- He did not focus on the "incidence of the tax."

DISSENT

- Justice Roberts dissented, joined by Justices Thomas, Alito, and Kavanaugh, arguing that "[b]ecause Washington is taxing Cougar Den for possessing fuel, not for traveling on the highways, the State's method of administering its fuel tax is consistent with the treaty."

POTENTIAL IMPLICATIONS

- On-reservation economic growth and development opportunities:
  - Ex: Yakama Nation could purchase other goods in Oregon or Idaho, then transport those goods on state highways to the Yakama Reservation, and not be subject to certain state taxes.
  - Ex: Could potentially relieve taxes on construction materials for development on-reservation.
- Case could signal SCOTUS shift in favor of tribal interests.

OPPORTUNITY ZONES IN INDIAN COUNTRY

WHAT ABOUT OZ?

- Incentivizes investment in areas that might otherwise be overlooked
  - 8,700 OZs, many of which are in Indian Country
  - In Washington alone, OZs in territory controlled by 17 tribes
- Applies to investments in active trades and businesses, real estate, many types of project financing, and more
- A mechanism for impact investing

THE POLICY

- The Opportunity Zone ("OZ") incentive was enacted as part of the tax reform bill in December 2017
- Goal is to spur long-term investment, economic growth and job creation in low-income and adjacent communities
- A descendent of Empowerment/Enterprise Zones, and New Markets Tax Credit

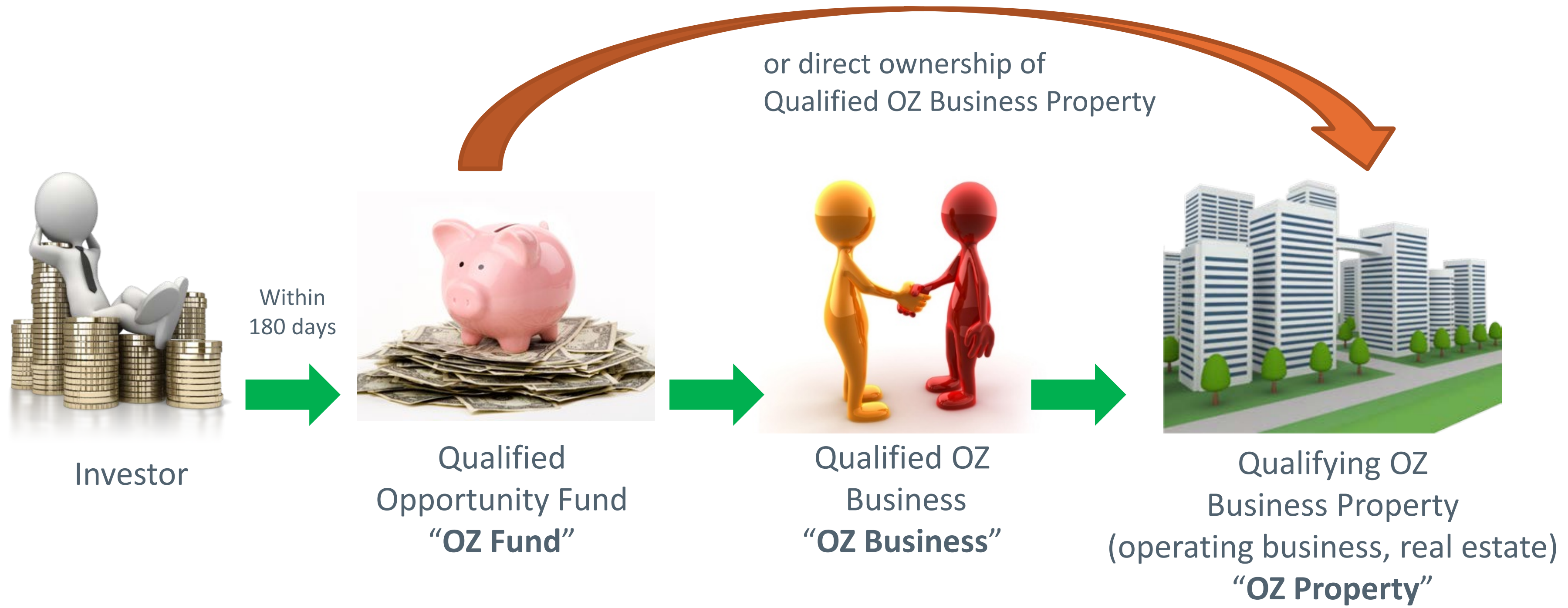
WHY YOU NEED TO KNOW ABOUT OZ

- *If you have money*, because there are significant tax benefits for investors with capital gains
  - Defer tax until 2026 on capital gains invested in Opportunity Funds
  - 10% increase in basis if investment held 5 years before 12/31/26
  - Additional 5% increase in basis if investment held 7 years before 12/31/26
  - *Capital gain* on investments held at least 10 years completely free from U.S. federal income tax (state treatments vary)
  - May be possible to also avoid depreciation recapture
- *If you need money*, because OZ financing can decrease cost of capital for entrepreneurs and developers
- *If you have something to sell in an OZ*, because OZ benefits can increase your sale price
- *If you want to promote economic development*, because the benefits above draw people to attractive investments

QUALIFYING ACTIVITIES AND BUSINESSES

- Must be a "trade or business"
  - Depending on structure, must be "active"
- Real estate (residential, commercial)
- Retail & hospitality
- Medical clinics, day care facilities
- Energy generation, storage, transmission
- Farming
- Manufacturing
- Distribution/warehouse
- Transportation and infrastructure
- Research
- Start-ups & incubators

EXAMPLE OF A BASIC OZ MODEL



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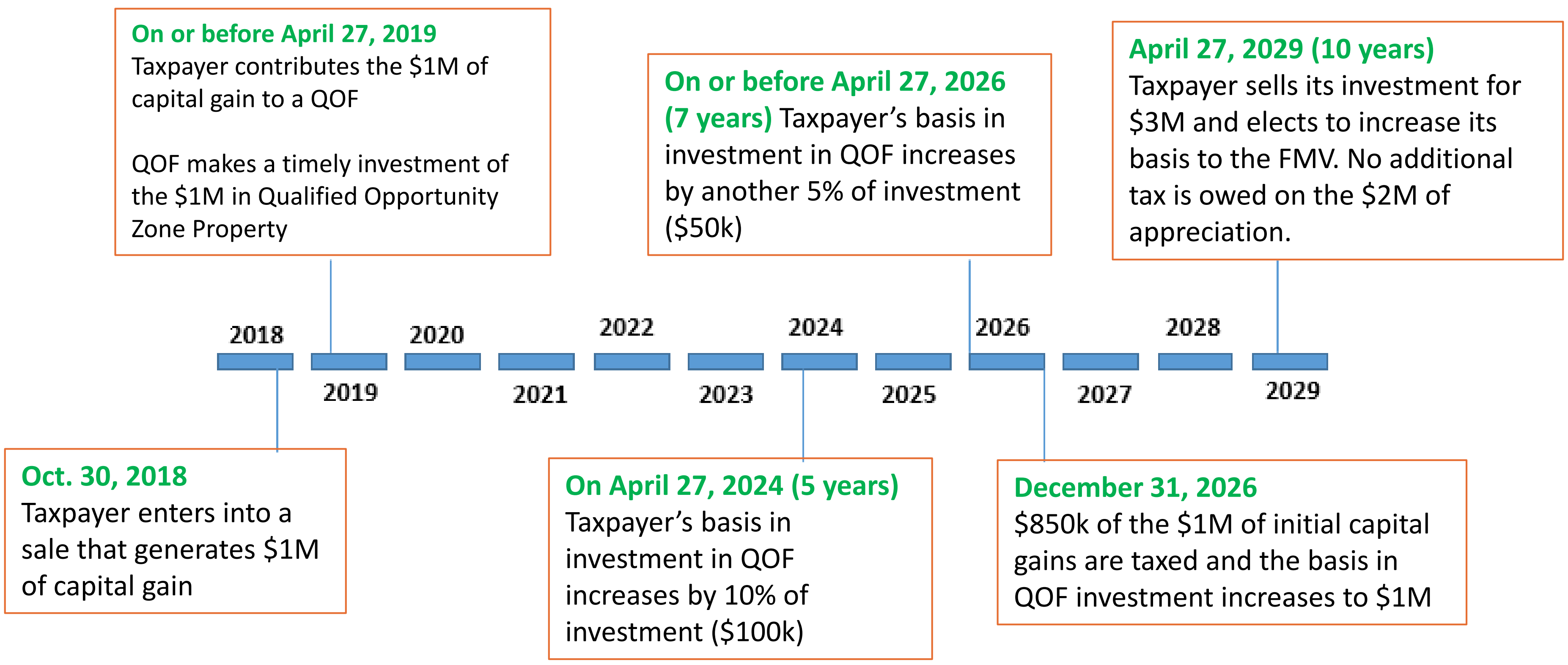
QUALIFIED OPPORTUNITY ZONE INCENTIVE TIMELINE EXAMPLE



NOTE: For this example, the Taxpayer's initial basis is $0 in the QOF investment and that the Taxpayer's basis in its QOF interest is not adjusted for any reason other than as a result of the steps shown above. Please note that a Taxpayer's basis in its QOF interest may be increased or decreased for other reasons under generally applicable rules of U.S. federal income tax law.

THE DEFINITIONS

- OZ Fund
  - Any investment vehicle organized as a corporation or partnership (which can include LLCs) for the purpose of investing in Qualified Opportunity Zone Property
  - Funds can be a mix of capital gains and non-capital gains (but only capital gains share qualifies for special tax treatment)
  - Funds self-certify annually to Treasury whether they meet requirements to comply with the OZ program (Form 8996)

THE DEFINITIONS

- OZ Business
  - Substantially all the tangible property owned or leased is OZ business property. 70% threshold applies
  - At least 50% of gross income derived from *active* trade/business
  - Substantial amount of any intangible property is used in the *active* trade or business
  - Limits on financial property (deter passive investment) 31 month safe harbor for working capital
  - May maintain 5% of assets in cash or equivalents
  - No “sin” businesses

THE DEFINITIONS

- OZ Property
  1. OZ stock in an OZ business
  2. OZ partnership interest (capital or profits) in an OZ business (includes LLCs)
  3. OZ business property (QOZBP)
     - Tangible property used in a trade or business of the QOF
     - Acquired by purchase after 12/31/2017
     - Original use in the OZ begins with the QOF (new) or substantially improved property (improvements at least double basis). Land not considered.
     - Substantially all the use is in an OZ

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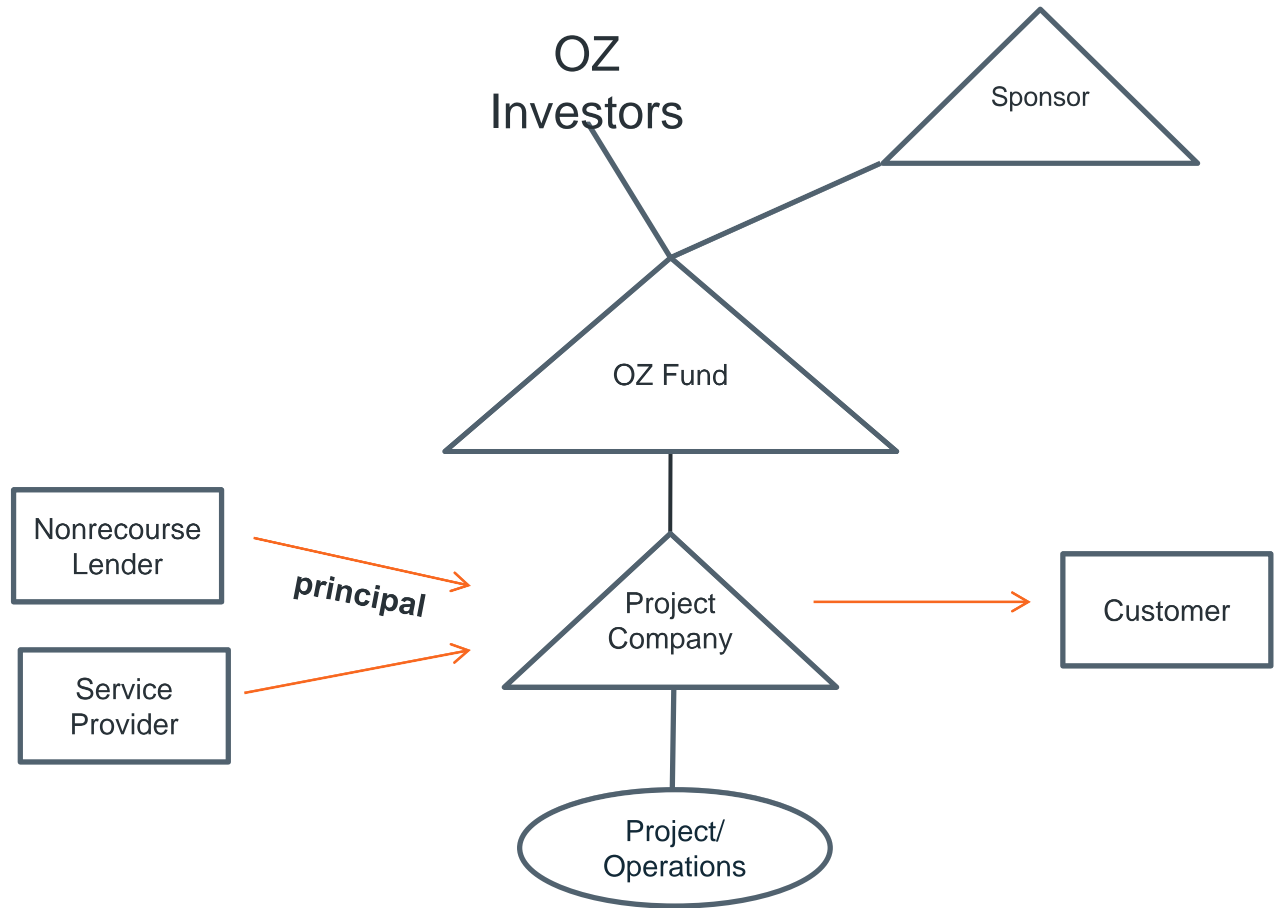
Direct Investment



Direct Investment Model

Pros
- Easy to administer
- Only one set of opportunity zone requirements to meet
- Well suited for **real estate** or **project finance** investments if the asset will be completed quickly, generally within six months after taxpayer's investment

Cons
- Requires that capital invested into the OZ Fund be deployed within six months after investment
- Due to time limits under the OZ incentive, poorly suited for longer-term projects from a sponsor perspective because construction may begin without a firm commitment of capital from equity investors
- At least 90% of the project assets must be tangible personal property that qualifies for the opportunity zone incentive

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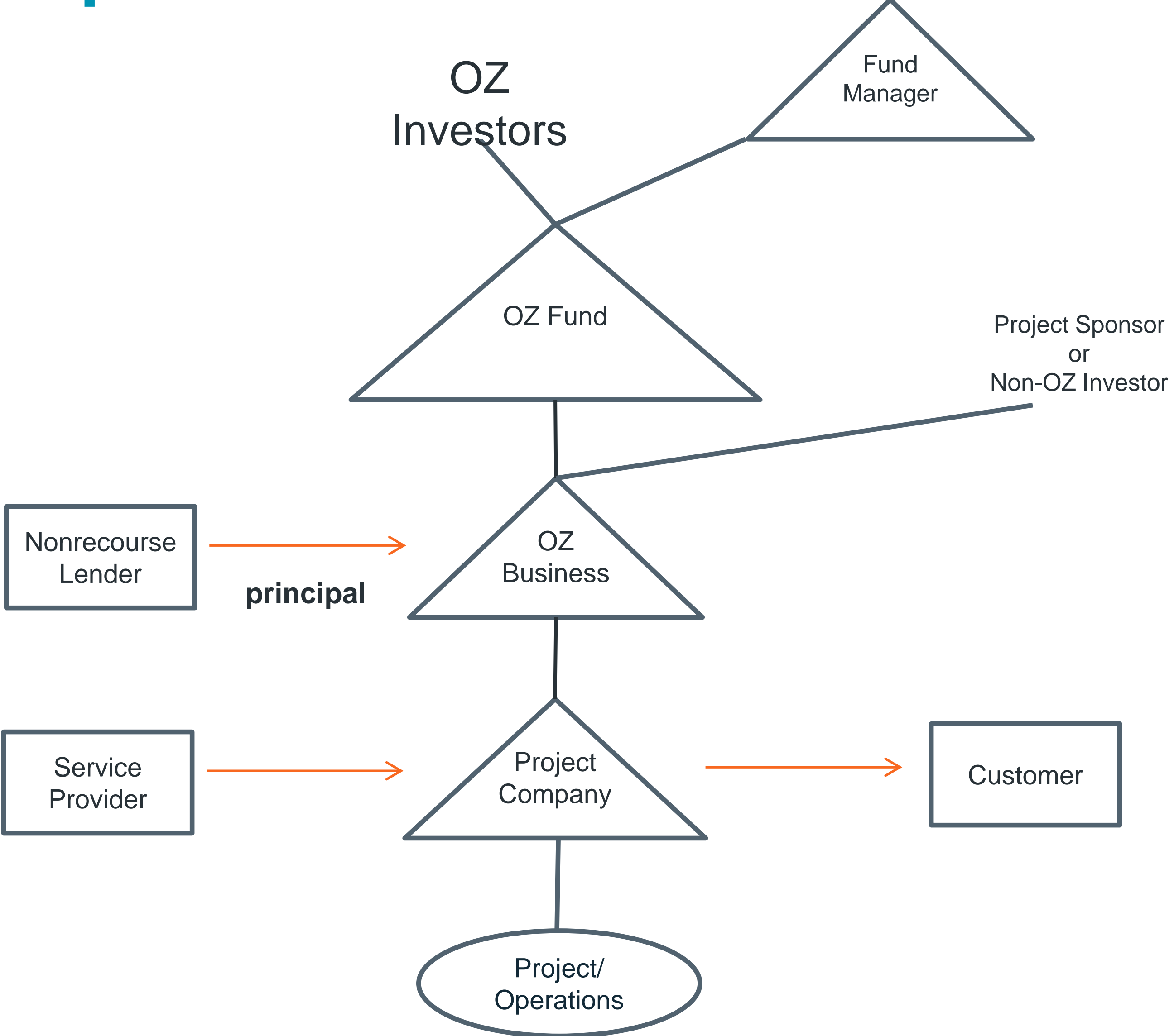
Two-Step Model



Two-Step Model

Pros

- More time to deploy capital: potentially up to 36 months (but 30 months is a more conservative assumption) after investment into the QOF
- Lender is in a more typical position
- May be possible to avoid OZ investor having liability for debt
- More extra cash can be held in the structure
- OZ Business (but not an OZ Fund) can own intellectual property
- Well suited for operating businesses, longer-term project finance (e.g., energy generation and infrastructure), longer-term real estate development (e.g., malls, hospitality, or planned communities)

Cons

- Somewhat more complicated to administer, but the structure is generally consistent with many other models in real estate and project finance
- Two sets of opportunity zone requirements to meet: one for the QOF and one for the QOZB
- Due to time limits under the OZ incentive, poorly suited for longer-term project finance from a sponsor perspective because construction will likely begin without a firm commitment of capital from equity investors

How to exit an OZ structure

- Sell OZ Fund interests
- OZ Fund sale of its assets
- Redemption of OZ Investors
  - Refinancing