Client Alert

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Federal Rule and Ninth Circuit Opinion Create Huge Opportunities on Indian Land

Lessees of Indian land can pursue refunds of property taxes paid on their permanent improvements and should appeal future assessments.

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In a set of comprehensive regulations affecting non-agricultural leasing on Indian land, the Department of the Interior, Bureau of Indian Affairs made sweeping changes and largely exempted property taxes on permanent improvements, possessory interest taxes on leasehold interests held by non-tribal members, and other state and local taxes on activities conducted by non-members on leased Indian land. In addition, a recent Ninth Circuit Court of Appeals decision affirmed that the taxes on permanent improvements were never lawful. Taxpayers in California that lease tribal land should immediately consider filing suits for refund and assessment appeals after receiving their tax bills.

In some densely populated portions of California, many types of business operate on leased Indian land, including hotels, resorts, golf courses, casinos and shopping centers. In cities like Palm Springs, single-family homes, apartment buildings and condominium complexes are on leased Indian land. Under the jurisdiction of the Palm Springs Agency of the Department of the Interior, Bureau of Indian Affairs (BIA), there are 1,175 commercial leases, 7,671 residential subleases, and 11,118 time shares on Indian land.[1] All of these properties may now be exempt from property taxes, and many of the taxes paid in the past several years may be available in refund suits.

Congress has expressly granted the BIA authority to approve leases on Indian land.[2] In 2012, the BIA promulgated a new set of regulations covering non-agricultural surface leasing, which became

[1] See http://www.bia.gov/WhoWeAre/RegionalOffices/Pacific/WeAre/PalmSprings/index.htm.

[2] 25 U.S.C. § 415. See 25 C.F.R. § 162.003 ("*Indian land* means any tract in which any interest in the surface estate is owned by a tribe or individual Indian in trust or restricted status and includes both individually owned Indian land and tribal land.").

effective on January 4, 2013 (the "Rule").[3] Section 162.017 of the Rule states that "Subject only to applicable law," states and local governments may not impose a tax on:

a. **Permanent improvements** on leased Indian land, regardless of who owns the improvements;
b. **Activities** under a lease conducted on the leased premises; and
c. **Leasehold or possessory interests**.[4]

Viewed broadly, this provision arguably establishes a wholesale exemption from these taxes, all of which were previously subject to the *Bracker* balancing test.[5]

In March 2013, a lawsuit challenging the Rule was filed in the Central District of California, *Desert Water Agency v. United States Department of the Interior*.[6] The District Court dismissed the case on January 21, 2014, on the grounds that it was not yet ripe and the plaintiff had no standing because it had not yet suffered any injury. A second suit was filed in the Central District of California on January 2, 2014 (*Agua Caliente II*)[7], in which the Agua Caliente tribe seeks to block Riverside County from imposing possessory interest taxes on its lessees under the Rule. To date, no court has addressed the validity and enforceability of the Rule.

Meanwhile, in July 2013, in *Confederated Tribes of the Chehalis Reservation v. Thurston County Board of Equalization*,[8] the Ninth Circuit Court of Appeals held that permanent improvements on tribal land are not subject to state and local taxes, regardless of ownership (which is exactly what Section 162.017(a) of the Rule states). Because the taxes at issue in that case were from years prior to the Rule's adoption and the Rule simply clarifies what is already in the federal statute, 25 U.S.C. § 465, the court expressly declined to consider whether the Rule applied.[9] (Pillsbury Winthrop Shaw Pittman attorneys Kevin Fong and Blaine Green represented the Chehalis Tribe in that appeal.)

In California, the remaining question for tribes and their lessees is how the Rule and the *Chehalis* case apply to the tax on possessory interests, particularly because California's possessory interest tax is imposed on both the leasehold interest and on the permanent improvements.[10] Some issues are clear, while others are in flux until the courts eventually determine the legality and scope of the Rule.

As important background, there are two Ninth Circuit cases from the 1970s involving the California tax on possessory interests on Indian land. In *The Agua Caliente Band of Mission Indians v.*

[3] "Residential, Business, and Wind and Solar Resource Leases on Indian Land," 77 Fed. Reg. 72440 (Dec. 5, 2013) (codified at 25 C.F.R. Part 162).

[4] 77 Fed. Reg. 72472 (emphasis added). For purposes of this alert, we are concerned with property taxes, so we only discuss paragraphs (a) and (c).

[5] In 1980, in *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, the Supreme Court addressed whether a particular state or local tax on non-tribal interests on Indian land is preempted by federal law. *Bracker* established a balancing test that weighs the federal, state, and tribal interests.

[6] Case No. 5:13-cv-00606-DMG-OP, filed March 29, 2013.

[7] *Agua Caliente Band of Cahuilla Indians v. Riverside County*, Case No. ED CV: 14-00007.

[8] 724 F.3d 1153 (9th Cir. 2013).

[9] *Id.* at fn. 6. 25 U.S.C. § 465 states, in part, "Title to any lands or rights acquired pursuant to this Act or the Act of July 28, 1955 (69 Stat. 392), as amended (25 U.S.C. 608 et seq.) shall be taken in the name of the United States in trust for the Indian tribe or individual Indian for which the land is acquired, and such lands or rights shall be exempt from State and local taxation."

[10] A possessory interest is generally defined to be a private interest in publicly owned property. Classic examples include an airline's lease at an airport and a shipping container company's lease at a harbor. Under RTC § 107, a possessory interest tax is imposed on two separate interests. Subdivision (a) imposes the tax on the leasehold interest in exempt land and improvements, and subdivision (b) imposes it on the improvements owned by the lessee that are affixed to the exempt land.

Riverside County,[11] the court held that the possessory interests of non-Indians on Indian land were taxable because "The California tax on possessory interests does not purport to tax the land as such, but rather taxes the 'full cash value' of the lessee's interest in it."[12] Citing the Supreme Court decision *United States v. City of Detroit*,[13] the court made the distinction that "a tax upon the use of property is not a tax upon the property itself."[14] Five years later, in *Fort Mojave Tribe v. County of San Bernardino*,[15] the court affirmed its holding in *Agua Caliente*.

In the *Chehalis* case last year, the Ninth Circuit distinguished its holding prohibiting property taxes on improvements on Indian land from the *Agua Caliente* and *Fort Mojave* cases, stating that the taxes at issue in those cases were permissible because they were only taxing the leasehold possessory interest, not the improvements.

What this Means for Businesses and Individuals Leasing Indian Land in California

Regardless of how the courts view the Rule, after *Chehalis*, property taxes on permanent improvements on Indian land are prohibited in the Ninth Circuit, including California. This includes property taxes imposed under Revenue and Taxation Code (RTC) § 107(b) on the permanent improvements on Indian land owned by the non-Indian lessees.[16] Taxpayers that have paid any such property taxes should consider seeking refunds immediately, if they have not already done so. To obtain refunds of property taxes illegally assessed and collected, a taxpayer must follow a specific set of statutory guidelines, and must adhere to strict statutes of limitations. Generally, taxpayers may obtain refunds of taxes paid during the four years prior to the time a claim is made, so it is crucial that a claim be made immediately so as to not foreclose prior years. Moreover, it must be the party who actually paid the tax that makes the claim for refund, so taxpayers waiting for the tribal lessors to take action are walking away from their refunds.

Whether counties could continue to impose a possessory interest tax under RTC § 107(a) on the leasehold interest in the land depends on how the courts apply and enforce the Rule. At the very least, the Rule is a strong statement of federal interest under the *Bracker* balancing test so as to render *Agua Caliente* and *Fort Mojave* obsolete, given that both cases pre-dated *Bracker*. If the courts ultimately uphold the Rule, the private leasehold interests held by non-Indians will no longer be subject to the possessory interest tax under RTC § 107(a). As taxpayers receive their tax bills this year beginning in July, they should consider immediately filing assessment appeals so as to preserve their rights in the event the federal courts uphold the Rule.

As the *Agua Caliente II* case proceeds in the Central District of California, we will have a better sense of the application and enforcement of the Rule, including the impact it has on taxpayers going forward, and we will update our alerts. However, in the meantime it is important to take action to obtain refunds of taxes paid that were illegally imposed, given the Ninth Circuit's ruling in *Chehalis*.

This material is not intended to constitute a complete analysis of all tax considerations Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties,

[11] 442 F.2d 1184 (9th Cir. 1971).
[12] *Id*. at 1186.
[13] 355 U.S. 466 (1958).
[14] 442 F.2d at 1187.
[15] 543 F.2d 1253 (9th Cir. 1976).
[16] Under RTC § 107(b), taxpayer-owned improvements on exempt government land are taxable possessory interests.

a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. This material does not meet those requirements. Accordingly, this material was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or of promoting, marketing or recommending to another party any tax-related matters.

If you have any questions about the content of this, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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