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Message from the Chair

STATE OF THE SECTION

the mission of our Section is “[t]o advance the understanding” of Indian Law. In our first executive council meeting this year, we talked a lot about our goals for the Section. The discussion covered a wide range of topics, including our usual activities and how they fit with our purpose. Not only have we decided on our goals, but we are already making progress.

The most important task we have to accomplish this year is supporting the State Bar’s petition to include topics on Indian Law as a fair game subject for the Bar Exam. The petition is the result of years of effort by the Indian Law Section and it is time for our hard work to come to fruition. We have formed a bar exam committee headed by past-chair Amy Courson to lead our effort. If you are interested in participating, please e-mail Teri Yeates at Teri.Yeates@staff.azbar.org and she can provide you information on the committee’s next meeting.

Katosha Nakai, as chair-elect, will put together our State Bar CLE seminar. We already have a topic. The seminar will provide an update on the water settlements and then examine how Tribal governments can use the water they have secured. I expect a great turnout for this program.

We will be continuing with some of our mentoring activities this year. There will be a writing competition for law students at ASU and U of A. Brad Downes put together the issue and it has already been circulated. Please also watch for our upcoming student mixers.

Finally, a word about the future. Beginning next year, our hope is that the Section can put together more timely and helpful CLE programs in addition to our annual seminar at the State Bar Convention. Marnie Hodahkwen of the Native American Bar Association attended our first meeting this year and it appears we will have a future partner in our education efforts.

A final word of thanks to Sheri Freemont, who put this newsletter together, and to everyone who contributed to this issue.

A Substantial Burden:

Navajo Nation v. United States Forest

by April Olson



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he Ninth Circ American Indian religious freedom with its en banc decision in *Navajo Nation v. U.S. Forest Serv.*, 535 F.3d 1058 (9th Cir. 2008)(en banc). The en banc panel reversed the decision of the three member panel in *Navajo Nation v. USFS*, 479 F.3d 1024 (9th Cir. 2007) that had declared the use of recycled wastewater on the San Francisco Peaks to be a “substantial burden” on the Navajo and Hopi tribes’ exercise of religion in violation of the Religious Freedom Restoration Act (RFRA).

The Religious Freedom Restoration Act

The Religious Freedom Restoration Act of 1993 (“RFRA”) was enacted in response to the Supreme Court’s decision in *Employment Division, Department of Human Resources of Oregon v. Smith*.¹ In *Smith*, the Court rejected the application of the compelling

government interest test to an unemployment compensation claim brought solely under the Free Exercise Clause of the First Amendment. The claimants in *Smith* challenged an Oregon statute that denied employment benefits to drug users, including members of the Native American Church who used peyote in religious ceremonies. In a seeming departure from precedent, the Court’s majority held that the Free Exercise Clause does not prohibit burdens on religious practices that are imposed by “neutral” laws of general applicability, like the Oregon statute.²

Congress passed RFRA three years after *Smith*, finding that laws “neutral” towards religion may still unnecessarily burden the exercise of religion and that the compelling governmental interest test is a “workable test for striking sensible balances between religious liberty and competing prior government interests.”³ A declared purpose of RFRA was to restore the compelling interest test as set forth in *Sherbert v. Verner*⁴ and *Wisconsin v. Yoder*.⁵ The “exercise of religion” was

Serv., 535 F.3d 1058 (9th Cir. 2008)



originally defined under this version of RFRA as the “exercise of religion under the First Amendment of the Constitution.”⁶

In *City of Boerne v. Flores*, the Supreme Court held RFRA unconstitutional as applied to state and local governments.⁷ The Court found that Congress had exceeded its power under Section 5 of the 14th Amendment with the enactment of RFRA.⁸ The Court did not address the constitutionality of RFRA as applied to the federal government but the Ninth Circuit subsequently upheld the constitutionality of RFRA as applied to the federal government.⁹

Congress enacted the Religious Land Use and Institutionalized Persons Act of 2000 (“RLUIPA”)¹⁰ in response to *City of Boerne*. Like its predecessor RFRA, RLUIPA prohibits state and local governments from imposing substantial burdens on the exercise of religion; however, the prohibited conduct only applies to prisoner or land use regulations.¹¹ RLUIPA also

amended the definition of the “exercise of religion” under RFRA. The “exercise of religion” under either RLUIPA or RFRA is now defined as “any exercise of religion, whether or not compelled by, or central to, a system of religious belief.”¹²

While the intent behind RFRA was to restore the pre-*Smith* compelling governmental interest test of *Sherbert* and *Yoder*, it has been suggested that RFRA and RLUIPA afford even more protection to the exercise of religion than cases pre-*Smith*.¹³ First, RFRA goes beyond the Constitutional language that states the government shall not “prohibit” the free exercise of religion, finding instead that the government may not “burden” religion, except under certain circumstances. Second, RFRA imposes a least restrictive means test on government conduct that was not required before *Smith*. Third, RFRA imposes the *Sherbert* compelling governmental interest test on *all* governmental burdens on the free exercise of religion, not just those in the unemployment compensation field, as was the case prior to



Smith. Finally, the definition of religion under the 2000 Amendments to RFRA (and under RLUIPA) encompasses a broader range of religious conduct than under the Supreme Court’s interpretation of the “exercise of religion” under the First Amendment.¹⁴

The Peaks Case

The San Francisco Peaks (the “Peaks”) consist of a single, large mountain composed of Humphrey’s Peak, Agassiz Peak, Doyle Peak and Fremont Peak. The Peaks are located within 1.8 million acres of the Coconino National Forest in northern Arizona and have long-standing religious significance to many tribes in the southwest. The Arizona Snowbowl is a ski area and recreation area located on Humphrey’s Peak, arguably one of the most religiously significant peaks. The Peaks are religiously significant to the tribes for various reasons¹⁵ including: that the Peaks are home to deities and other spiritual beings; that the water, soil, plants and

In 2002, the owners of the Arizona Snowbowl Resort Limited Partnership (the “Snowbowl”) submitted a facilities improvement proposal to the United States Forest Service (USFS). The Snowbowl proposal included the proposed use of millions of gallons of recycled sewage¹⁷ from the City of Flagstaff to make artificial snow. The treated sewage would be supplied by Flagstaff and sprayed on the Peaks from November through February. The proposal further provided for the construction of a reservoir that would store 10 million gallons of treated sewage so snowmaking could continue after Flagstaff cut off the supply in February.

The USFS approved the proposed expansion of the Snowbowl facilities after completion of a Final Environmental Impact Statement (FEIS). Several Indian tribes¹⁸ and environmental organizations challenged the USFS decision to approve the proposal under several statutes including: the Religious Freedom Restoration

Act¹⁹ (RFRA), the National Environmental Protection Act²⁰ (“NEPA”), and the National Historic Preservation Act²¹ (“NHPA”).²² Under RFRA, the various tribes asserted that the use of treated sewage to make artificial snow would substantially burden their exercise of religion. Uncontroverted testimony at trial confirmed that pollution of the Peaks with wastewater would prevent tribes from exercising their religion including conducting religious ceremonies and obtaining medicine.²³



animals from the Peaks have spiritual and medicinal qualities; that the tribes have a duty to protect the Peaks and that the Peaks and everything on them form an indivisible living entity.¹⁶

After a bench trial, the district court held that the projected Snowbowl expansion did not violate RFRA.²⁴ The court explained that the tribes had not proved that such action would prevent them from “engaging in conduct or having a religious experience *which the faith mandates*.”²⁵ The district court also granted summary



judgment to the defendants on the NEPA and NHPA claims.²⁶

On appeal, a three member panel of the Ninth Circuit concluded that under RFRA, the use of treated sewage effluent to make artificial snow substantially burdened the exercise of religion for the Navajo and Hopi tribes, and that such a burden was not justified by a compelling governmental interest with the least restrictive means.²⁷ In making this determination, the court applied a four part test: 1) what is the “exercise of religion” in which tribal members engage with respect to the Peaks; 2) what burden, if any, would be imposed on that religion if the proposed expansion of the Snowbowl went forward; 3) if there is a burden, is it substantial; and 4) if there is substantial burden, can it be justified in furtherance of a compelling governmental interest with the least restrictive means.²⁸

The En Banc Ninth Circuit Decision

The en banc panel of the Ninth Circuit considered the same foundational questions as the three member panel of the Ninth Circuit, holding that to establish a prima facie RFRA claim a plaintiff must first show: a) that the activities burdened by the government were an “exercise of religion;” and, b) that the exercise of religion was “substantially burden[ed]” by the government’s action.²⁹ The defendants in the Peaks case did not challenge whether the tribes’ religious activities on the Peaks were an “exercise of religion” and both panels of the Ninth Circuit found this first requirement met. The heart of the case therefore turned on the second requirement and what constitutes a “substantial burden” by the government on the free exercise of religion. Adopting a restrictive definition of “substantial burden”, the en banc panel ultimately held that the use of the recycled wastewater was not a substantial burden on the tribes’ exercise of religion within the meaning of RFRA.³⁰

To reach its determination, the en banc panel explained it was guided by decades of Supreme Court precedent.³¹ Using *Yoder*³² and *Sherbert*³³ as foundation, the court declared a substantial burden was imposed only in two situations: when individuals are forced to choose between their religion and a government benefit, or when they are coerced to act in violation of their religious beliefs under the threat of civil or criminal sanctions.³⁴

The court declined to find the tribes in the Peaks case were penalized in any way, and explained “[t]he only effect of the proposed upgrades is on the Plaintiffs’ subjective, emotional religious experience. That is, the presence of recycled wastewater on the Peaks is offensive to the Plaintiff’s religious sensibilities.”³⁵ The court held this insufficient to meet the substantial burden test under RFRA.³⁶

Circuit Judge William Fletcher, joined by Judges Pregerson and Fisher, strongly dissented arguing that majority “misstates the evidence below, misstates the law under RFRA, and misunderstands the very nature of religion.”³⁷ The dissent vigorously disagreed with the majority’s reliance on *Yoder* and *Sherbert* for an absolute definition of “substantial burden” and proffered six reasons why that reliance was misplaced.

First, the dissent disagreed with the majority’s contention that burdens on religion can only be created in two ways: by imposition of a penalty or denial of a government benefit.³⁸ The dissent argues for a more plain and ordinary reading of “substantial burden” which does not depend on deprivation of a benefit or a penalty. Relying on the dictionary definitions of substantial and burden, the dissent would have RFRA prohibit “government action that ‘hinders or oppresses’ the exercise of religion ‘to a considerable degree.’”³⁹ The dissent argues that had Congress wished to impose the majority’s substantial burden standard, it could have easily done so by explicitly stating such in RFRA.⁴⁰

Second, RFRA’s purpose is explicitly stated as “to restoring the compelling interest test as set forth in [*Sherbert* and *Yoder*].”⁴¹ The dissent contends that in enacting RFRA Congress intended to restore the application of strict scrutiny to all government actions substantially burdening religions and reject the line of cases following *Yoder* and *Sherbert* that refused to apply the compelling governmental interest test or applied a watered down version of strict scrutiny.⁴² RFRA says nothing about restoring the definition of “substantial burden” or even the previous definition of the “exercise of religion.” In fact, RFRA expanded the definition of the “exercise of religion.”⁴³ Since Congress did not define “substantial burden” in RFRA, it should be defined according to its ordinary meaning.⁴⁴



Third, the dissent contends that the majority's restrictive definition of "substantial burden" is not supported by *Yoder*, *Sherbert* or any other pre-RFRA case.⁴⁵ While *Yoder* and *Sherbert* involved burdens on religion that imposed a penalty or denied a benefit, neither case suggested burdens on religion were limited to such situations. The dissent explained "the text, purpose, and enactment history of RFRA make equally clear that RFRA protects against burdens that, while imposed by a different mechanism than those in *Sherbert* and *Yoder*, are also 'substantial.'"⁴⁶

Fourth, RFRA's express purpose rejected the restrictive approach to Free Exercise claims that came about in *Smith*. The dissent argued that the majority approach is at odds with the stated purpose.⁴⁷ RFRA created a legally protected interest in the exercise of religion and such interests can be burdened in ways that do not deny a benefit or impose a penalty. The dissent cites Ninth Circuit precedent that has found religion burdened in ways beyond the majority's restrictive definition. In *Mockaitis v. Harcleroad*, for example, the court held that prison officials substantially burdened religious exercise when they recorded the confession of a Catholic inmate.⁴⁸ In *Shakur v. Schriro* the court found that under RLUIPA, the failure of a prison to provide a Muslim inmate with Halal or Kosher meat could constitute a substantial burden on religion.⁴⁹ The dissent argued that the majority's restrictive approach is in contrast to RFRA's directive to apply the compelling government interest test in all cases where there is a substantial burden on the exercise of religion.⁵⁰

Fifth, the majority's restrictive definition of "substantial burden" is in conflict with prior RFRA precedent of the Ninth Circuit.⁵¹ The dissent discusses both *Mockaitis* and other cases at odds with the majority's approach.

Finally, the dissent argues that the Ninth Circuit's interpretation of "substantial burden" under RLUIPA is at odds with the majority's "newly minted *Sherbert* test."⁵² The dissent argued that the Ninth Circuit has defined substantial burden under RLUIPA "according to the effect of the government action on religious exercise rather than particular mechanisms by which this effective is achieved."⁵³ Citing *Shakur* and *Mockaitis* again as well

as *Bryant v. Gomez*⁵⁴ the dissent highlights inconsistencies in the application of RFRA and RLUIPA.

In addition to the restrictive definition of "substantial burden" the dissent takes issue with the majority's statement that RLUIPA doesn't apply to RFRA suits and the applicability of RFRA to federal land.⁵⁵ The dissent also maintains the majority misunderstands the "nature of religious belief and practice" and finds fault with the majority's willingness to characterize the Indians religious beliefs as a "subjective spiritual experience."⁵⁶ The dissent sharply describes the majority's motivation to do so as "an excuse for refusing to accept the Indians' religion as worthy of protection under RFRA."⁵⁷

Conclusion⁵⁸

The Peaks case presents difficult obstacles for those seeking to protect traditional religious beliefs from governmental interference and constricts the additional free exercise protections under RFRA. In the Ninth Circuit a "substantial burden" on the exercise of religion can only be found when the government imposes a penalty or denies a benefit. Only when this high standard is met does the burden shift to the government to show that such burden is justified by a compelling government interest in the least restrictive means.

We need not wait long or look far to see the impacts of this decision in Indian country. The Peaks case has already been used against another tribe. In *Snoqualmie Indian Tribe v. Fed. Energy Reg. Comm'n*, No. 05-72739 (9th Cir. October 7, 2008), the Ninth Circuit used the decision in *Navajo Nation* against the Snoqualmie Tribe to declare the proposed government action did not substantially burden the exercise of religion simply because it did not impose a penalty or deny a government benefit. A substantial burden on religion outside the two categories established by *Navajo Nation* was not even considered by the court. The court explained "[t]he Tribe's arguments that the dam interferes with the ability of tribal members to practice religion are irrelevant to whether the hydroelectric project either forces them to choose between practicing their religion and receiving a government benefit."⁵⁹



endnotes

- 1 Employment Division, Department of Human Resources of Oregon v. Smith, 494 U.S. 872 (1990).
- 2 *Id.*
- 3 42 U.S.C. §§ 2000bb-a.
- 4 Sherbert v. Verner, 374 U.S. 398 (1963).
- 5 Wisconsin v. Yoder, 406 U.S. 205 (1972).
- 6 42 U.S.C. § 2000bb-2(4) (1994) (repealed).
- 7 City of Boerne v. Flores, 521 U.S. 507 (1997).
- 8 *Id.* at 529, 534-35.
- 9 See Guam v. Guerrero, 290 F.3d 1210, 1220-21 (9th Cir. 2002).
- 10 42 U.S.C. §§ 2000cc et seq.
- 11 42 U.S.C. §§ 2000cc, 2000 cc-1.
- 12 42 U.S.C. §§ 2000bb-2(4), 2000cc-5(7)(A).
- 13 Navajo Nation v. U.S. Forest Serv., 535 F.3d 1058, 1084 (9th Cir. 2008) (en banc).
- 14 42 U.S.C. § 2000bb-2(4), 2000cc-5(7)(A). See also *Guru Nanak Sikh Soc’y v. County of Sutter*, 456 F.3d 978, 995 (9th Cir. 2006).
- 15 The Peaks are held sacred by many tribes for reasons distinct to each particular tribe, although commonalities may be found between them. In light of time and space considerations, this article has not detailed the reasons why the Peaks are sacred to each separate tribe. This omission in no way intends to disregard the individual beliefs of each tribe. For some discussion on the Peaks significance to the Navajo, the Hopi, the Havasupai and the Hualapai see *Navajo Nation v. U.S. Forest Serv.*, 479 F.3d 1024, 1034-38 (9th Cir. 2007).
- 16 Navajo Nation, 535 F.3d at 1082.
- 17 The terms treated sewage effluent, recycled wastewater and recycled sewage are used interchangeably in the various court decisions in this case.
- 18 The term “tribes” include tribes and individual members of the: Navajo Nation, Havasupai Tribe, White Mountain Apache Nation, Yavapai-Apache Nation, Hualapai Tribe and the Hopi Tribe.
- 19 42 U.S.C. §§ 200bb et seq.
- 20 42 U.S.C. §§ 4321 et seq.
- 21 16 U.S.C. §§ 470 et seq.
- 22 This article will only address the RFRA claim.
- 23 Navajo Nation v. U.S. Forest Serv., 479 F.3d 1024, 1040-41 (9th Cir. 2007).
- 24 Navajo Nation v. U.S. Forest Serv., 408 F. Supp. 2d 866, 907 (D. Ariz. 2006).
- 25 *Id.* at 904 (quoting *Worldwide Church of God v. Philadelphia Church of God, Inc.*, 227 F.3d 1110, 1121 (9th Cir. 2000)).
- 26 Navajo Nation, 408 F. Supp. 2d at 907.
- 27 Navajo Nation, 479 F.3d at 1048.
- 28 *Id.* at 1033-34.
- 29 Navajo Nation, 535 F.3d at 1068.
- 30 *Id.* at 1078. Since no substantial burden was found and thus no prima facie case under RFRA established, the en banc panel did not address whether the burden would serve a compelling government interest with the least restrictive means.
- 31 *Id.* at 1068.
- 32 Wisconsin v. Yoder, 406 U.S. 205 (1972).
- 33 Sherbert v. Verner, 374 U.S. 398 (1963).
- 34 Navajo Nation, 535 F.3d at 1070.
- 35 *Id.*
- 36 *Id.*
- 37 *Id.* at 1082.
- 38 *Id.* at 1086.
- 39 *Id.*
- 40 *Id.* At 1087.
- 41 42 U.S.C § 2000bb(b).
- 42 Navajo Nation, 535 F.3d at 1087.
- 43 42 U.S.C. §§ 2000bb-2(4), 2000cc-5(7)(A).
- 44 Navajo Nation, 535 F.3d at 1088.
- 45 *Id.*
- 46 *Id.* at 1090.
- 47 *Id.*
- 48 Mockaitis v. Harclerod, 104 F.3d 1522, 1531 (9th Cir. 1997).
- 49 Shakur v. Schriro, 514 F.3d 878, 888-89 (9th Cir. 2008).
- 50 Navajo Nation, 535 F.3d at 1091 (citing 42 U.S.C. § 2000bb(a)(5)).
- 51 Navajo Nation, 535 F.3d at 1091.
- 52 *d.* at 1093.
- 53 *Id.*
- 54 Bryant v. Gomez, 46 F.3d 949 (9th Cir. 1995).
- 55 Navajo Nation, 535 F.3d at 1094-96.
- 56 *Id.* at 1096.
- 57 *Id.*
- 58 A thorough analysis of the three Peaks cases and their impact on American Indian religious freedom is probably more suitable for a law review than a newsletter article. The synopsis provided here is only a cursory examination of the issues and readers are encouraged to read all three cases themselves.
- 59 *Snoqualmie Indian Tribe v. Fed. Energy Reg. Comm’n*, No. 05-72739 slip op at 14247 (9th Cir. October 7, 2008)(*emphasis added*).

April Olson is an Assistant General Counsel for the Gila River Indian Community Law Office.
Any opinions expressed in this article are the author’s alone and any legal analysis is not to be relied upon.



2008-2009 WRITING COMPETITION

THE STATE BAR OF ARIZONA INDIAN LAW SECTION IS PLEASED
TO ANNOUNCE THIS SCHOLARLY WRITING COMPETITION

TOPIC

The papers should accomplish the following:

Provide an in-depth discussion of the past and current legal authority for development of renewable and non-renewable energy resources on Indian lands by federally recognized Indian tribes, tribal enterprises, and/or non-Indian entities. The paper should discuss the recently enacted Indian Tribal Energy Development and Self Determination Act of 2005 and include a comparison of the advantages and disadvantages of utilizing Tribal Energy Resource Agreements (“TERA”) versus tribes developing the subject resources directly or through tribal enterprises such as a Section 17 corporation without utilizing a TERA.

Describe how you would advise a tribal government regarding its options with respect to the development of renewable and non-renewable energy resources on Indian lands considering the Indian Tribal Energy Development and Self Determination Act of 2005 and any cases you deem relevant.

Conclude with a projection of how you believe the law will develop in this area.

Be creative and do not merely reiterate the applicable statute(s) or regulations or the facts and holdings of case law.

ELIGIBILITY

All Juris Doctoral and LLM students attending the Sandra Day O’Connor College of Law at Arizona State University, The University of Arizona James E. Rogers College of Law, and the Phoenix School of Law are eligible. Students from any other degree program are not eligible.

AWARDS

Up to two cash prizes may be awarded depending upon the quality of the entries received. No more than one prize will be awarded to an LLM candidate. Each prize will be a scholarship check in the amount of \$1,000. Scholarship checks will be presented at the annual State Bar of Arizona Convention.

The winning essays will be submitted to *The Arrow* for publication in its Spring or Fall 2009 edition.



DEADLINE FOR SUBMISSION

Essays must be received no later than **March 31, 2009**.

ESSAY REQUIREMENTS

Essays must be the original work product of a single individual and must be prepared for this competition and not previously published. No multiple author entries will be accepted. One student may submit more than one essay. This essay contest does not allow for editing of essays by law professors or writing instructors; however, papers prepared to fulfill substantial writing requirements are eligible for submission provided that such entries comply with all contest rules.

Papers will be judged by an anonymous panel on the basis of the overall quality of the paper as determined by the panel. Any paper submitted must be of publication quality, regardless of the number of entries.

Each entrant must assign to the State Bar of Arizona Indian Law Section all right, title, and interest in the essay submitted. It is the policy of the Indian Law Section to relinquish the assignment of rights in all but the winning essays after the panel has made their decision.

The essay is to be submitted in electronic format, on either a floppy disk or CD-ROM, in either Word or WordPerfect format, double-spaced in 12 point Times New Roman font with one inch margins. The essay must be of a length between twelve and fifteen pages.

The completed and signed Entry and Agreement Form must be submitted along with the electronic copy. All information must be included on the Entry and Agreement Form in order for the essay to be considered. Please do not place your name on the essay itself, only on the Entry and Agreement Form and on the disk or CD.

Faxes will not be accepted. The disk or CD and the Entry and Agreement form should be mailed first-class, without folding, ***and must be received on or before March 31, 2009***. All entries must be mailed to:

Indian Law Section Writing Competition
State Bar of Arizona
Attn: Teri Yeates
4201 N. 24th Street, Suite 200
Phoenix, AZ 85016-6288

Questions about the competition should be directed to:

- ▶ Amy Courson, 520.795.8727, or e-mail at ACourson@stricklandlaw.net
- ▶ Bradley G. Bledsoe Downes, 480.346.4216, or e-mail at bdownes@bdrllaw.com

Thank you and good luck!





BARONA V. YEE

STATE TAXATION OF TRIBAL CONSTRUCTION PROJECTS

by Ronald N. Rosier

in *Barona v. Yee*¹ the Ninth Circuit Court of Appeals (“Court of Appeals”) held that federal law does not preempt application of California sales tax on construction materials purchased for a tribal project by a non-Indian subcontractor from non-Indian vendors, but delivered to a tribe’s reservation. If not overturned by the Court of Appeals *en banc* or reversed by the U.S. Supreme Court, this decision may lead other states in the Ninth Circuit to tax tribal construction projects since, by and large, most construction industry providers are non-Indian.

In *Barona v. Yee*, the Barona Band of Mission Indians (“Barona” or “Tribe”) entered into a lump-sum contract with a non-Indian general contractor to construct a \$75 million casino expansion (“Project”). In turn, the general contractor hired Helix Electrical, Inc. (“Helix”), a non-Indian subcontractor, to perform the electrical work for the project.

Under California’s statutes and regulations, “*either sales tax or use tax applies with respect to the sale of the materials to or the use of materials by the construction contractor.*”² Further, California defines a lump-sum contract as “*a contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both.*”³

To avoid imposition of California sales tax on its casino expansion, Barona included the following conditions in its contract with the general contractor: (i) Barona designated the general contractor and subcontractors as Tribal purchasing agents for the procurement of construction materials; (ii) construction materials had to be delivered and accepted by the Tribe on-reservation; (iii) title to construction materials would pass to the purchaser on-reservation; and (iv) advance payments for construction materials could not be made prior to the delivery of such items to the construction site.

After completion of the Project, the California State Board of Equalization (“Board”) audited Helix’s books and records and, despite the Tribal conditions recited above intended to avoid the application of State sales tax, the Board assessed approximately \$200,000 in sales tax against Helix related to the purchase of construction materials. Indemnification provisions in the prime contract and Helix’s subcontract required Barona to indemnify the parties against imposition of state sales tax. Therefore, Barona filed for declaratory relief in the United States District Court for the Southern District of California (“District Court”) to contest the application of the State sales tax to Helix, and, therefore, the Tribe.



The Tribe asserted that federal law barred application of the State sales tax because: (i) the legal incidence of the tax fell upon Barona since it designated Helix as a tribal purchasing agent and the sale of construction materials occurred on-reservation; (ii) if the legal incidence of the tax fell upon Helix, federal law preempts the tax since federal and tribal interests in promoting tribal economic development and self-sufficiency outweigh state interest in raising tax revenue; and (iii) the Indian Gaming Regulatory Act (“IGRA”) preempts the tax.⁴

Although the District Court declined to accept Barona’s designation of Helix as a tribal purchasing agent, it determined that the legal incidence of the sales tax fell upon Helix and that federal law preempted such tax. The District Court’s *Bracker*⁵ preemption analysis focused on the effect the tax would have on Indian gaming, an industry significantly regulated under federal law – IGRA. The District Court reasoned that application of state sales tax on construction materials would substantially increase the cost of Barona’s casino expansion and perhaps discourage Barona from building an optimal casino facility to attract gaming patrons. The District Court also noted that Barona contributes pursuant to its tribal-state gaming compact revenue to California to mitigate off-reservation impacts caused by its tribal gaming activities. Based upon these considerations, the District Court concluded that the federal and tribal interests expressed in IGRA to promote tribal economic development, self-sufficiency and strong tribal governments outweighed the State’s general interest in raising tax revenue.

The Court of Appeals summarily rejected the idea that Barona could designate Helix as its purchasing agent for purposes of avoiding state sales tax and reversed the District Court decision that federal law preempted the sales tax. The Court of Appeals construed the Project’s sales tax mechanism as a contractual manipulation to create a non-taxable event in Indian Country that would otherwise be taxable off-reservation. This perception significantly affected the Court of Appeals’ analysis under the *Bracker* preemption test resulting in a decision favoring the application of State sales tax.

The Court of Appeals discounted Tribal interests in territorial autonomy, economic development and self-sufficiency because it concluded that Barona sought to create an artificial economic advantage over non-Indian businesses akin to those discussed in the historical tribal smoke shop cases.⁶ In regard to federal interests in tribal self-sufficiency, the Court of Appeals explained that such interest “fades when the commercial activity is rigged to trigger a tax exemption.” The Court of Appeals agreed that IGRA comprehensively regulates Indian gaming, but that the State sales tax on construction materials was too far removed from IGRA to serve as a basis to preempt such tax. Similarly, Barona’s payments to the State to mitigate off-reservation impacts were considered too far removed from the subject matter of the state sales tax to be relevant.

Alternative California Project Delivery Methods

The California sales tax regulation that applies to Indian reservations exempts state sales tax upon sales of tangible personal property to tribes when delivery of the property and title to the property transfers to the tribe on-reservation.⁷ Thus, if the Tribe, and not Helix, had purchased the construction materials, State law would have exempted such sales from State sales tax assuming delivery of the property and title transferred to the Tribe on-reservation.

California regulations also provide that State sales tax does not apply to Indian contractors if construction materials sold to Indian contractors are delivered on-reservation.⁸ The Indian contractor is not required to be a tribal member or reside on the reservation of the tribe for which such contractor is performing the work.⁹

Finally, California law allows tribes to enter into properly structured time and materials contracts wherein non-Indian general contractors and non-Indian subcontractors are deemed retailers of construction materials sold to the tribe. Although the contractors install the construction materials sold to tribes as in lump-sum projects, the sale of construction materials are exempt under a time and materials contract if: (i) construction



materials are delivered to the tribe on-reservation; (ii) title to the materials passes to the tribe on-reservation prior to installation; and (iii) the retail transactions are documented by exempt resale certificates.¹⁰ In the District Court case, the Board admitted that state sales tax would not have applied to Barona's casino expansion had the parties entered into a properly structured time and materials contract.¹¹

Arizona Transaction Privilege Tax

Unlike California, Arizona imposes a transaction privilege tax on the business of prime contracting rather than a direct tax upon the sale of construction materials.¹² The Arizona transaction privilege tax rate of 5% applies to 65% of the gross proceeds of sales or gross income derived from the business of prime contracting.¹³ However, local governments also tax construction activities and depending upon the location of the project, the combined State and county transaction privilege tax rates for prime contracting range from 5.85% to 6.725%.¹⁴ Since on-reservation tribal construction projects do not occur within city territorial limits, this article does not address city taxes applied to construction projects.

The legal incidence of the Arizona transaction privilege tax falls upon the prime contractor.¹⁵ A "prime contractor" is a contractor that supervises, performs or coordinates the construction project, hires subcontractors, if any, and is responsible for completion of the project.¹⁶ In a typical construction project involving an owner, general contractor and subcontractors, the general contractor is the prime contractor. Under certain circumstances a project manager, construction manager or subcontractor may be deemed the prime contractor.

Subcontractors are not subject to transaction privilege tax if: (i) the job is within the control of a prime contractor; and (ii) the prime contractor is liable for the transaction privilege tax on the gross income, gross proceeds of sales or gross receipts attributable to the job from which the subcontractor was paid.¹⁷ Subcontractors are exempt from transaction privilege tax unless they act in the capacity of a prime contractor.¹⁸ A Subcontractor is deemed a prime contractor and liable for the tax if the subcontractor performs work for

and receives payment from: (i) an owner-builder, or (ii) an owner or lessee of real property.¹⁹

Arizona exempts on-reservation construction projects from the application of transaction privilege tax. In April 1995, the Arizona Department of Revenue ("Department of Revenue") issued Transaction Privilege Tax Ruling 95-11 ("TPR 95-11"). In regard to construction activities, TPR 95-11, subsection I(C), provides that transaction privilege tax does not apply to the gross proceeds derived from on-reservation contracting activities performed by an Indian tribe, a tribal entity or a tribal member. In addition, subsection I(C) provides that the tax does not apply to the gross proceeds derived from construction projects performed on-reservations by non-Indian prime contractors when: (1) the activity is performed for the tribe or a tribal entity on its reservation; or (2) the activity is performed for a tribal member on his or her reservation.

Based upon the Arizona transaction privilege tax scheme and the exemption provided in TPR 95-11, non-Indian contractors performing on-reservation tribal construction projects are not subject to transaction privilege tax imposed on prime contracting. If *Barona v. Yee* stands, it will be interesting to see whether the Department of Revenue will seek to eliminate the non-Indian contractor exemption in TPR 95-11.

Elimination of the on-reservation prime contractor exemption and attempted tax of tribal construction projects may present challenges for the State. Key factors in the *Barona v. Yee* case may be inapplicable to the Arizona transaction privilege scheme for taxing prime contracting. First, the structure of the Arizona transaction privilege tax, itself, does not require contractual manipulation to create a taxable event on-reservation for purposes of the *Bracker* preemption analysis. Since the taxable event is prime contracting, on-reservation construction by non-Indian contractors results in the legal incidence of the transaction privilege tax occurring within Indian Country.²⁰ Thus, federal and tribal interests should not be automatically discounted under the *Bracker* preemption analysis, as in *Barona v. Yee*, since contractual manipulation is not required to place the taxable event in Indian Country.



Second, the transaction taxed in *Barona v. Yee* involved non-Indian purchases of construction materials. The Court of Appeals more than once noted that under the *Bracker* preemption test the weighing of federal, tribal and state interests tips in favor of the state where its taxes are imposed on the purchases made by non-Indians. However, Arizona's transaction privilege tax applies to prime contracting activities and not upon the prime contractor's purchase of construction materials.²¹ Therefore, under the *Bracker* preemption analysis a presumption that state interests outweigh federal and tribal interest by the mere structure of the taxing scheme should not apply.

It is also worth mentioning that, Arizona's transaction privilege tax on prime contracting is similar to the New Mexico's gross receipts tax that was preempted as applied to the construction of an on-reservation tribal school. See, *Ramah Navajo School Board, Inc. v Bureau of Revenue of New Mexico*.²² In *Ramah*, a tribal school board contracted with a non-Indian contractor to construct a tribal school on-reservation. New Mexico imposed a tax on the gross receipts received by the non-Indian contractor from the tribal school board. In that case, the Supreme Court determined that federal law preempted New Mexico's gross receipts tax applied to the non-Indian contractor because federal regulation and financing of Indian education was comprehensive and federal interest in promoting educational opportunities for Indians outweighed New Mexico's interest in raising general tax revenue. Depending upon the individual

factors involved in a given tribal construction project, *Ramah* may be a difficult case to overcome regarding the potential application of Arizona transaction privilege tax on prime contractors hired by tribes to construct on-reservation tribal projects.

Finally, the removal of the non-Indian prime contractor exemption from TPR 95-11 would likely not affect the ability of Arizona tribes to form their own construction companies to perform tax exempt tribal construction projects on-reservation. Federal law bars state taxation of on-reservation tribal activity where the legal incidence of the tax falls on the tribe or its tribal members.²³ The legal incidence of Arizona's transaction privilege tax falls upon the prime contractor.²⁴



Conclusion

Barona v. Yee's potential application is not limited to California tribal construction projects. Based upon the broad wording of the decision, it is arguable that an enterprising Department of Revenue could seek to modify TPR 95-11 to apply the transaction privilege tax on current and future construction projects involving the non-Indian prime contracting. However, it would be imprudent to determine that *Barona v. Yee* applies to all tribally owned construction projects utilizing non-Indian contractors given that individual tribal projects could involve government or commercial components or both and could involve significant comprehensive and pervasive federal regulation.



endnotes

- 1 528 F.3d 1184 (9th Cir. 2008).
- 2 Cal. Admin. Code tit. 18 § 1521 (b)(2)(A)
- 3 *Id.* § 1521(a)(8).
- 4 *Barona v. Yee*, No. 05CV257, slip op. at 4 (S.D. Cal. May 22, 2006).
- 5 *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980).
- 6 *Barona*, F.3d at 1191 (referencing *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134 (1980)).
- 7 Cal. Admin. Code tit. 18, § 1616(d)(4)(A) (“*Generally ownership to property transfer upon delivery if delivery is made by facilities of the retailer and ownership transfers upon shipment if delivery is made by mail or common carrier.*”).
- 8 *Id.* § 1616(d)(4)(C)(1).
- 9 Cal. Sales Tax Ruling 305.0028.750 (August 5, 1997).
- 10 Cal. Sales Tax Ruling 305.0028.025 (June 12, 2002).
- 11 *Barona v. Yee*, No. 05CV257, slip op. at 12 (S.D. Cal. May 22, 2006).
- 12 Ariz.Rev.Stat. §§ 42-5008, 42-5010(a)(1)(h).
- 13 *Id.* § 42-5075(B).
- 14 Arizona Department of Revenue, “Transaction Privilege and Other Taxable Rate Tables,” (July 1, 2008), available at <http://www.azdor.gov/TpT/tprates/2008/Jul1.pdf>.
- 15 *Tucson Mechanical Contracting Inc. v Arizona Dept. of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (Ariz.App. Div. 1, 1992).
- 16 Ariz.Rev.Stat. § 42-5075(O)(8) (defining “prime contractor” as “a contractor who supervises, performs or coordinates the construction, alteration, repair, addition, subtraction, improvement, movement, wreckage or demolition of any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement including the contracting, if any, with any subcontractors or specialty contractors and is responsible for the completion of the contract.”); See also § 42-5075(O)(2) (defining “contractor”).
- 17 Ariz.Rev.Stat. § 42-5075(D). See also § 42-5075(D) (providing an exempt tax certificate procedure for subcontractors to obtain a certificate from a prime contractor indicating that the prime contractor is the person liable for the tax).
- 18 Ariz. Admin. Code § R15-5-602.
- 19 *Id.*
- 20 See Arizona Department of Revenue, Harold Scott, Arizona Transaction Privilege Tax Ruling TPR 93-40, (July 6, 1993), available at <http://www.revenue.state.az.us/ResearchStats/rulings/tpr93-40.htm> (stating in relevant part “[u]nder the prime contracting classification the taxable event takes place at the site where the actual contracting activity is conducted.”).
- 21 Pursuant to Ariz.Rev.Stat. § 42-5061(A)(27), Arizona transaction privilege tax does not apply to the sale of materials if the materials are incorporated into the construction project.
- 22 458 U.S. 832, 844 (1982) (noting that the New Mexico gross receipts tax is intended to compensate the State for the privilege of engaging in business).
- 23 *Barona*, 528 F.3d at 1189, (citing *Oklahoma Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450 (1995)).
- 24 *Tucson Mechanical Contracting Inc.*, *supra* n. 16.

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