South Point Energy Center LLC v. Arizona Dept. of Revenue, 251 Ariz. 263, 490 P.3d 372 (Ct. App. 2021)

- **Holdings:** 25 U.S.C. § 5108 categorically preempts state taxation on permanent improvements made to Indian trust land even when the tax is paid by a non-Indian entity. Whether the taxed property is a permanent improvement or personal property must be determined with reference to federal law standards.
- **Summary:** Plaintiff/Appellant is non-Indian entity that owns and operates an electrical generating plant on leased land held in trust for the Fort Mojave Indian Tribe. Under the lease, it may "'remove any and all above ground Improvements and personal property from the Leased Land,' except for certain roads, foundations, and underground piping and equipment." The Arizona tax court granted summary to the state department of revenue, concluding that the facility is not a permanent structure for purposes of 25 U.S.C. § 5108 because the lease requires such removal of "above-ground improvements" at its conclusion and, as such, did not categorically preempt the tax. It then applied the balancing test in *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980), and determined that the state tax was not preempted. The court of appeals reversed and remanded for further proceedings for on the question whether the facility constitutes a permanent improvement to the leased land or personal property under federal law principles and, if not, to apply the *Bracker* test.

  Section 5108 authorizes the Secretary of the Interior to take land into trust for Indians. Its final paragraph states in relevant part: "Title to any lands or rights acquired pursuant to this Act ... 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." The panel first rejected the department's contention that the statute's tax prohibition was limited to property situated on trust property and owned by Indians. "[A]pplying the text of § 5108 and the reasoning of the several federal cases applying the statute, we conclude that a tax on any permanent improvements subject to the Lease is effectively a tax on one of the privileges of the Tribe's ownership of trust land, and therefore is barred by § 5108." *See Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973); *United States v. Rickert*, 188 U.S. 432 (1903); *Seminole Tribe of Florida v. Stranburg*, 799 F.3d 1324 (11th Cir. 2015); *Confederated Tribes of the Chehalis Reservation v. Thurston Cnty. Bd. of Equalization*, 724 F.3d 1153 (9th Cir. 2013). The panel next rejected the argument that § 5108 did not embody a per se prohibition of the involved tax but, instead, required conducting a *Bracker* weighing of the competing federal, state and tribal interests. In its view, "*Bracker* has nothing to say about property that is categorically exempt from taxation under § 5108." Nor did 25 C.F.R. § 162.017(a)—which provides that "[s]ubject only to applicable Federal law, permanent improvements on the leased land, without regard to ownership of those improvements, are not subject to any fee, tax, assessment, levy, or other charge imposed by any State or political subdivision of a State"—counsel application of the *Bracker* test. Although the panel agreed that "*Bracker* constitutes 'federal law,' 'federal law' also includes § 5108." Given the "unambiguous[]" § 162.017 and the fact that "federal law—including *Rickert*, *Mescalero*, *Chehalis*, and *Stranburg*—does not conflict with this language, the regulation's language supports our interpretation of § 5108."

The remaining issue, therefore, was whether the above-ground portion of the generating plant was a permanent improvement or personal property. The tax court had decided this issue without briefing or evidence based upon the taxpayer's right to remove it upon lease termination. The panel held this to be error because "the tax court disregarded the principle that federal law, not state law, determines whether specific property is a permanent improvement exempt from taxation under § 5108." It continued on to hold that "[u]nder federal tax law, whether an asset is a permanent improvement or personal property turns on six factors set out in *Whiteco Indus., Inc. v. Comm'r*, 65 T.C. 664 (1975)." The *Whiteco* factors are:

> (1) "Is the property capable of being moved, and has it in fact been moved?"; (2) "Is the property designed or constructed to remain permanently in place?"; (3) "Are there circumstances which tend to show the expected or intended length of affixation, i.e., are there circumstances which show that the property may or will have to be moved?"; (4) "How substantial a job is removal of the property and how time-consuming is it? Is it 'readily removable'?"; (5) "How much damage will the property sustain upon its removal?"; and (6) "What is the manner of affixation of the property to the land?"

The panel accordingly remanded the "case to the tax court to conduct a *Whiteco* analysis to determine which, if any, of the assets that make up the Facility are permanent improvements that therefore are exempt from taxation under § 5108. The court then should consider whether property taxes on the assets that are not permanent improvements are preempted under *Bracker*."

- **Relevant (2020) Deskbook Section:** 11:5 nn.7, 11, 12
- **Comment:** The court of appeals' interpretation that § 5108 imposes a per se prohibition on taxation of non-Indian-owned permanent improvements is questionable. *See Desert Water Agency v. U.S. Dep't of Interior*, 849 F.3d 1250 (9th Cir. 2017); *Herpel v. County of Riverside*, 45 Cal. App. 5th 96, 258 Cal. Rptr. 3d 444 (Div. 2 2020); *Pickerel Lake Outlet Association v. Day County, South Dakota*, 2020 SD 72, 953 N.W.2d 82 (2020).