STATE OF CALIFORNIA

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Executive Director

December 18, 2015

Dear Interested Party:

Enclosed is the Initial Discussion Paper on Regulation 1616, *Federal Areas*. Before the issue is presented at the Board's May 24, 2016 Business Taxes Committee meeting, staff would like to invite you to discuss the issue and present any additional suggestions or comments. Accordingly, an interested parties meeting is scheduled as follows:

January 13, 2016
Room 122 at 10:00 a.m.
450 N Street, Sacramento, CA

If you would like to participate by teleconference, call 1-888-808-6929 and enter access code 7495412. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at Susanne.Buehler@boe.ca.gov by January 29, 2016. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

If you are interested in other Business Taxes Committee topics refer to our webpage at (http://www.boe.ca.gov/meetings/btcommittee.htm) for copies of discussion or issue papers, minutes, a procedures manual, and calendars arranged according to subject matter and by month.

Thank you for your consideration. We look forward to your comments and suggestions. Should you have any questions, please feel free to contact our Business Taxes Committee staff member Mr. Michael Patno at 1-916-323-9676, who will be leading the meeting.

Sincerely,

Susanne Buehler

Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB:map

Enclosures

cc: (all with enclosures, via email and/or hardcopy as requested)
Honorable Jerome E. Horton, Chairman, Third District
Senator George Runner (Ret.), Vice Chair, First District
Honorable Fiona Ma, CPA, Member, Second District
Honorable Diane L. Harkey, Member, Fourth District
Honorable Betty T. Yee, State Controller, c/o Ms. Yvette Stowers (MIC 73)
Ms. Kari Hammond, Board Member's Office, Third District
Ms. Shellie Hughes, Board Member's Office, Third District
Ms. Camille Dixon, Board Member's Office, Third District
Mr. Sean Wallentine, Board Member's Office, First District
Mr. Lee Williams, Board Member's Office, First District
Mr. Brian Wiggins, Board Member's Office, First District
Mr. Cary Huxsoll, Board Member's Office, First District
Mr. Alfred Buck, Board Member's Office, First District
Mr. Jim Kuhl, Board Member's Office, Second District
Ms. Kathryn Asprey, Board Member's Office, Second District
Mr. John Vigna, Board Member's Office, Second District
Mr. Tim Morland, Board Member's Office, Second District
Ms. Lizette Mata, Board Member's Office, Second District
Mr. Russell Lowery, Board Member's Office, Fourth District
Mr. Ted Matthies, Board Member's Office, Fourth District
Ms. Lisa Renati, Board Member's Office, Fourth District
Mr. Clifford Oakes, Board Member's Office, Fourth District
Mr. Ramon Salazar, State Controller's Office (MIC 73)
Ms. Cynthia Bridges (MIC 73)
Mr. Randy Ferris (MIC 83)
Mr. David Gau (MIC 101)
Ms. Lynn Bartolo (MIC 43 or 57)
Mr. Todd Gilman (MIC 70)
Mr. Wayne Mashihara (MIC 47)
Mr. Kevin Hanks (MIC 49)
Mr. Mark Durham (MIC 67)
Mr. Robert Tucker (MIC 82)
Mr. Jeff Vest (MIC 85)
Mr. Jeff Angeja (MIC 85)
Mr. David Levine (MIC 85)
Mr. Bradley Heller (MIC 82)
Mr. Lawrence Mendel (MIC 82)
Mr. John Thiella (MIC 73)
Ms. Kirsten Stark (MIC 50)
Mr. Marc Alviso (MIC 101)
Mr. Chris Lee (MIC 101)
Ms. Laureen Simpson (MIC 70)
Ms. Karina Magana (MIC 47)
Mr. Bradley Miller (MIC 92)
Mr. Bill Benson (MIC 67)
Ms. Tracy McCrite (MIC 50)
Mr. Michael Patno (MIC 50)

INITIAL DISCUSSION PAPER
Regulation 1616, *Federal Areas*

Issue

Whether the Board should amend Regulation 1616, *Federal Areas*, to clarify the application of tax to meals, food, and beverages sold for consumption in an Indian casino by an establishment that is leased by non-Indians.

Background

In *White Mountain Apache Tribe v. Bracker* (*Bracker*)[1], the United States Supreme Court explained that federally-recognized Indian tribes "retain 'attributes of sovereignty over both their members and their territory,'"[2] "as a separate people, with the power of regulating their internal and social relations, and thus far [are] not brought under the laws" of the United States or the states in which the tribes reside.[3] The Court also held that:

- Federal law preempts a state's authority to tax an activity undertaken on a "reservation or by tribal members"[4] in circumtances where the tax unlawfully infringes on the right of federally-recognized Indian tribes "to make their own laws and be ruled by them"[5]; and

- "[T]here is no rigid rule by which to resolve the question whether a particular state law may be applied to an Indian Reservation or to tribal members,"[6] and state taxation is preempted when "a particularized inquiry into the nature of the state, federal, and tribal interests at stake" indicate that, in a "specific context, the exercise of state authority would violate federal law"[7] because it unlawfully infringes on the right of federally-recognized Indian tribes "to make their own laws and be ruled by them."[8]

Therefore, the Board must review the particular facts and circumstances applicable to the imposition of California's sales and use taxes on activities conducted on Indian reservations[9] to determine whether the state, federal, and tribal interests at stake require federal preemption of the taxes under a *Bracker* analysis.

In addition, on February 25, 1987, the United States Supreme Court decided that neither the State of California nor Riverside County could regulate the bingo and card game operations of the

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[1] *White Mountain Apache Tribe v. Bracker* (1980) 448 U.S. 136

[2] 448 U.S. at p. 142 [quoting from *United States v. Mazurie* (1975) 419 U.S. 544, 557]

[3] 448 U.S. at p. 142 [quoting from *McClanahan v. Arizona State Tax Commission* (1973) 411 U.S. 164, 173, which was quoting from *United States v. Kagama* (1886) 118 U.S. 375]

[4] 448 U.S. at p. 143

[5] 448 U.S. p. 142 [quoting from *Williams v. Lee* (1959) 358 U.S. 217, 220]

[6] 448 U.S. at p. 142

[7] *Id.* at p. 145

[8] *Id.* at p. 142

[9] In this context, "reservation" includes reservations, rancherias, and any land held by the United States in trust for any Indian tribe or individual Indian. (Reg. 1616, subd. (d).)

Cabazon Band of Mission Indians and the Morongo Band of Cahuilla Mission Indians.[10] This Court ruling, known as the Cabazon decision, set in motion a series of federal and state actions, including two ballot measures, which dramatically expanded tribal casino operations in California as well as in other states.

The Cabazon decision relied heavily on principles of tribal sovereignty established in earlier cases, including *Bracker*. In its ruling, the United States Supreme Court rejected California's attempts to regulate tribal gambling enterprises within reservations in the absence of congressional authorization. In response to the Cabazon decision, the Congress passed the Indian Gaming Regulatory Act (IGRA) in 1988.[11] The act provides a statutory structure for federal, state, and tribal regulation of tribal gambling operations by making specified types of gaming lawful on Indian lands only if the state in which the lands are located and the Indian tribe[12] having jurisdiction over the Indian lands enter into a Tribal-State Compact governing gaming activities on the Indian lands of the Indian tribe with the approval of the Secretary of the Interior.[13] The act provides for a Tribal-State Gaming Compact to include provisions for "the assessment by the State of such activities in such amounts as are necessary to defray the costs of regulating such activity" and "taxation by the Indian tribe of such activity in amounts comparable to amounts assessed by the State for comparable activities." The act declares that its purpose is to advance three principal goals:

- Tribal economic development;
- Tribal self-sufficiency; and
- Strong tribal governments.[14]

The California Gambling Control Commission's (CGCC's) website at www.cgcc.ca.gov indicates that the "State of California has signed and ratified Tribal-State Gaming Compacts with 72 Indian tribes" and "[t]here are currently 60 casinos operated by 58 Tribes" in California. The CGCC's website also contains links to California's current Tribal-State Gaming Compacts, which generally require tribes operating casinos to pay the state a portion of their gaming revenues and make specified payments to be shared with non-gaming or limited gaming tribes.

The passage of the Helping Expedite and Advance Responsible Tribal Home Ownership Act (HEARTH Act) of 2012 amended the Indian Long-Term Leasing Act of 1955[15] and created a voluntary alternative land leasing process for restricted Indian lands. Under the HEARTH Act, once their governing tribal leasing regulations have been submitted to, and approved by, the Secretary of the Interior, tribes are authorized to negotiate and enter into business leases of tribal

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[10] *California v. Cabazon Band of Mission Indians* (1987) 480 U.S. 202

[11] Codified in 25 U.S.C § 2701 et seq.

[12] Defined in 25 U.S.C. § 2703

[13] 25 U.S.C. § 2710 (d)

[14] 26 U.S.C. § 2702

[15] 25 U.S.C. § 415

lands without further approval by the Secretary, including lands where tribal gaming activities are conducted in accordance with a Tribal-State Gaming Compact.

The new leasing regulations that interpret and explain the HEARTH Act issued by the Bureau of Indian Affairs (BIA) state that:

> Subject only to applicable Federal law, activities under a lease conducted on the leased premises are not subject to any fee, tax, assessment, levy, or other charge (e.g., business use, privilege, public utility, excise, gross revenue taxes) imposed by any State or political subdivision of a State. Activities may be subject to taxation by the Indian tribe with jurisdiction.[16]

As indicated by the Board's Chief Counsel, in an October 7, 2013, memorandum to the Board, the BIA has previously explained that this provision does not preempt all state taxation on leased Indian land, but expresses the BIA's view that the federal and tribal interests to be weighed in determining whether a state tax is preempted on leased Indian land are strong, for purposes of performing a *Bracker* analysis.

Regulation 1616

Revenue and Taxation Code section 6352 provides that California sales and use tax does not apply to transactions that the state is prohibited from taxing under federal or California law. Regulation 1616 was originally adopted in 1945 as a restatement of previous sales and use tax rulings regarding transactions that involved the U.S. military. In 1978, subdivision (d) was added to the regulation to prescribe the application of tax to the sale and use of tangible personal property on Indian reservations.

Based upon the Board's historic analyses of how federal law preempts California's sales and use tax, Regulation 1616, subdivision (d), currently provides that tax applies to on-reservation sales by non-Indian retailers to non-Indians and Indians not residing on the reservation, but does not generally apply to on-reservation sales to Indians residing on the reservation. The subdivision further provides that sales tax does not apply to any on-reservation sales made by Indian retailers, whether to Indians who reside on the reservation, non-Indians, or Indians who do not reside on the reservation. However, an on-reservation Indian retailer is responsible for collecting the use tax from non-Indians and Indians not residing on the reservation unless the on-reservation retail sale is otherwise not subject to tax. Furthermore, Indian retailers selling meals, food or beverages at eating and drinking establishments are not required to collect use tax on the sale of meals, food or beverages that are sold for consumption on an Indian reservation. Therefore, under the current provisions of Regulation 1616, subdivision (d), California sales and use tax does not apply to an Indian retailer's sales of meals, food, or beverages from an eating or drinking establishment in an Indian casino on a reservation for consumption in the casino. However, tax generally applies to such sales by non-Indian retailers, unless the sales are to Indians residing on the same reservation where the sales are made.

[16] 25 C.F.R. § 162.017 (b)

Recent *Bracker* Analysis of Sales by Non-Indian Lessees

California's Indian casinos compete with Indian and non-Indian casinos in other states for tribal gaming revenue, which is specifically intended, by the federal government, to aid in the economic development of California's Indian tribes, make the tribes self-sufficient, and enable them to have strong tribal governments, as provided in the IGRA. California's Indian casinos commonly offer similar food and beverages services to their customers as are offered by casinos operated in other states, as part of their integrated casino operations, to attract and retain customers, enhance their gaming revenue, and provide additional revenue from their casino operations. The revenues from these services satisfy their financial obligations to the state and other tribes under their Tribal-State Gaming Compacts and provide additional revenue for their tribal governments, as provided for under the IGRA. Some Indian tribes impose their own sales taxes on sales of meals, food, or beverages at their casinos to provide additional revenue to satisfy their financial obligations under their Tribal-State Gaming Compacts and to provide additional revenue for their tribal governments, as provided for under the IGRA. The food and beverage services are sometimes operated by non-Indian retailers who are leasing space, in accordance with federal law, including the HEARTH Act, in the casinos and are required to pay the tribal sales taxes with regard to their sales of meals, food, and beverages for consumption in the Indian casinos, as intended by the IGRA and the HEARTH Act.

The Board's Legal Department recently performed a *Bracker* analysis to determine whether federal law preempts the imposition of California sales and use taxes on sales of meals, food, and beverages by such a non-Indian lessee. The Legal Department concluded that the federal and tribal interests in preempting California's sales and use taxes outweighed the state's interest in imposing such taxes under unique circumstances. This occurs when a Tribal casino, operated under a Tribal-State Gaming Compact entered into in accordance with the IGRA, leases an establishment, such as a restaurant or bar, to a non-Indian who makes sales of meals, food and beverages on site for consumption in the tribal casino, and the sales are subject to a tribal sales tax.

Non-Indian Lessee Exemption Criteria

Staff has proposed revisions to Regulation 1616, subdivision (d), to clarify and provide additional notice that, under federal law, "California sales and use tax does not apply to sales of meals, food, and beverages by a non-Indian operating an establishment, such as a restaurant or bar, in leased space in an Indian tribe's casino, when the sales are subject to the Indian tribe's sales tax and the meals, food, and beverages are furnished for consumption in the casino."

Since the revisions address sales by non-Indians and Regulation 1616, subdivision (d)(3)(B) applies to sales by non-Indians, staff is recommending that the new language be included in new subdivision (d)(3)(B)3 (see Exhibit 1).

Non-substantive Changes

In addition to the proposed amendments regarding non-Indian lessees selling food and drinks for consumption in a casino, staff proposes non-substantive amendments to Regulation 1616 to delete a duplicative reference to Regulation 1574, update the reference to Regulation 1668,

reformat the references to Regulations 1521 and 1667, and address grammatical and typographical errors within the regulation.

Summary

Staff proposes amendments to Regulation 1616 to clarify that tax does not apply to sales of meals, food, and beverages by a non-Indian operating an establishment, in leased space in an Indian tribe's casino, when the sales are subject to the Indian tribe's sales tax and the meals, food, and beverages are furnished for consumption in the casino. Staff welcomes any comments, suggestions, and input from interested parties on this issue. Staff also invites interested parties to participate in the January 13, 2016, interested parties meeting. The deadline for interested parties to provide written responses regarding this discussion paper is January 29, 2016.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 12/14/2015

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Regulation 1616, Federal Areas.

Reference: Sections 6017, 6021, and 6352, Revenue and Taxation Code.
Public Law No. 817-76th Congress (Buck Act).
Vending machines, sales generally, see Regulation 1574.
~~Items dispensed for 10¢ or less, see Regulation 1574.~~

(a) In General. Tax applies to the sale or use of tangible personal property upon federal areas to the same extent that it applies with respect to sale or use elsewhere within this state.

(b) Alcoholic Beverages. Manufacturers, wholesalers and rectifiers who deliver or cause to be delivered alcoholic beverages to persons on federal reservations shall pay the state retailer sales tax on the selling price of such alcoholic beverages so delivered, except when such deliveries are made to persons or organizations which are instrumentalities of the Federal Government or persons or organizations which purchase for resale.

Sales to officers' and non-commissioned officers' clubs and messes may be made without sales tax when the purchasing organizations have been authorized, under appropriate regulations and control instructions, duly prescribed and issued, to sell alcoholic beverages to authorized purchasers. [1]

(c) Sales Through Vending Machines. Sales through vending machines located on Army, Navy, or Air Force installations are taxable unless the sales are made by operators who lease the machines to exchanges of the Army, Air Force, Navy, or Marine Corps, or other instrumentalities of the United States, including Post Restaurants and Navy Civilian Cafeteria Associations, which acquire title to and sell the merchandise through the machines to authorized purchasers.

For the exemption to apply, the contracts between the operators and the United States instrumentalities and the conduct of the parties must make it clear that the instrumentalities acquire title to the merchandise and sell it through machines leased from the operators to authorized purchasers.

(d) Indian Reservations.

(1) In General. Except as provided in this regulation, tax applies to the sale or use of tangible personal property upon Indian reservations to the same extent that it applies with respect to sale or use elsewhere within this state.

(2) Definitions. For purposes of this regulation “Indian” means any person of Indian descent who is entitled to receive services as an Indian from the United States Department of the Interior.

Indian organizations are entitled to the same exemption as ~~a~~an Indian~~s~~. “Indian organization” includes Indian tribes and tribal organizations and also includes partnerships all of whose

members are Indians. The term includes corporations organized under tribal authority and wholly owned by Indians. The term excludes other corporations, including other corporations wholly owned by Indians. "Reservation" includes reservations, rancherias, and any land held by the United States in trust for any Indian tribe or individual Indian.

(3) Sales by On-Reservation Retailers.

(A) Sales by Indians.

1. Sales by Indians to Indians who reside on a reservation. Sales tax does not apply to sales of tangible personal property made to Indians by Indian retailers negotiated at places of business located on Indian reservations if the purchaser resides on a reservation and if the property is delivered to the purchaser on a reservation. The purchaser is required to pay use tax only if, within the first 12 months following delivery, the property is used off a reservation more than it is used on a reservation.

2. Sales by Indians to non-Indians and Indians who do not reside on a reservation. Sales tax does not apply to sales of tangible personal property by Indian retailers made to non-Indians and Indians who do not reside on a reservation when the sales are negotiated at places of business located on Indian reservations if the property is delivered to the purchaser on the reservation. Except as exempted below, Indian retailers are required to collect use tax from such purchasers and must register with the Board for that purpose.

Indian retailers selling meals, food or beverages at eating and drinking establishments are not required to collect use tax on the sale of meals, food or beverages that are sold for consumption on an Indian reservation.

(B) Sales by non-Indians.

1. Sales by non-Indians to Indians who reside on a reservation. Sales tax does not apply to sales of tangible personal property made to Indians by retailers when the sales are negotiated at places of business located on Indian reservations if the property is delivered to the purchaser on a reservation. The sale is exempt whether the retailer is a federally licensed Indian trader or is not so licensed. The purchaser is required to pay use tax only if, within the first 12 months following delivery, the property is used off a reservation more than it is used on a reservation.

2. Sales by non-Indians to non-Indians and Indians who do not reside on a reservation. Either sales tax or use tax applies to sales of tangible personal property by non-Indian retailers to non-Indians and Indians who do not reside on a reservation.

3. California sales and use tax does not apply to sales of meals, food, and beverages by a non-Indian operating an establishment, such as a restaurant or bar, in leased space, in an Indian

tribe's casino, when the sales are subject to the Indian tribe's sales tax and the meals, food, and beverages are furnished for consumption in the casino.

(C) Resale Certificates. Persons making sales for resale of tangible personal property to retailers conducting business on an Indian reservation should obtain resale certificates from their purchasers. If the purchaser does not have a permit and all the purchaser's sales are exempt under paragraph (d)(3)(A) of this regulation, the purchaser should make an appropriate notation to that effect on the certificate in lieu of a seller's permit number (see Regulation 1668, ~~"~~*Sales for Resale ~~Certificates~~*~~"~~).

(4) Sales by Off-Reservation Retailers.

(A) Sales Tax - In General. Sales tax does not apply to sales of tangible personal property made to Indians negotiated at places of business located outside Indian reservations if the property is delivered to the purchaser and ownership to the property transfers to the purchaser on the reservation. Generally ownership to property transfers upon delivery if delivery is made by facilities of the retailer and ownership transfers upon shipment if delivery is made by mail or carrier. Except as otherwise expressly provided herein, the sales tax applies if the property is delivered off the reservation or if the ownership to the property transfers to the purchaser off the reservation.

(B) Sales Tax - Permanent Improvements - In General. Sales tax does not apply to a sale to an Indian of tangible personal property (including a trailer coach) to be permanently attached by the purchaser upon the reservation to realty as an improvement if the property is delivered to the Indian on the reservation. A trailer coach will be regarded as having been permanently attached if it is not registered with the Department of Motor Vehicles. Sellers of property to be permanently attached to realty as an improvement should secure exemption certificates from their purchasers (see Regulation 1667, ~~"~~*Exemption Certificates*~~"~~).

(C) Sales Tax - Permanent Improvements - Construction Contractors.

1. Indian contractors. Sales tax does not apply to ~~ales~~sales of materials to Indian contractors if the property is delivered to the contractor on a reservation. Sales tax does not apply to sales of fixtures furnished and installed by Indian contractors on Indian reservations. The term "materials" and "fixtures" as used in this paragraph and the following paragraph are as defined in Regulation 1521, ~~"~~*Construction Contractors*.~~"~~

2. Non-Indian contractors. Sales tax applies to sales of materials to non-Indian contractors notwithstanding the delivery of the materials on the reservation and the permanent attachment of the materials to realty. Sales tax does not apply to sales of fixtures furnished and installed by non-Indian contractors on Indian reservations.

(D) Use Tax - In General. Except as provided in paragraphs (d)(4)(E) and (d)(4)(F) of this regulation, use tax applies to the use in this state by an Indian purchaser of tangible personal property purchased from an off-reservation retailer for use in this state.

(E) Use Tax - Exemption. Use tax does not apply to the use of tangible personal property (including vehicles, vessels, and aircraft) purchased by an Indian from an off-reservation retailer and delivered to the purchaser on a reservation unless, within the first 12 months following delivery, the property is used off a reservation more than it is used on a reservation.

(F) Leases. Neither sales nor use tax applies to leases otherwise taxable as continuing sales or continuing purchases as respects any period of time the leased property is situated on an Indian reservation when the lease is to an Indian who resides upon the reservation. In the absence of evidence to the contrary, it shall be assumed that the use of the property by the lessee occurs on the reservation if the lessor delivers the property to the lessee on the reservation. Tax applies to the use of leased vehicles registered with the Department of Motor Vehicles to the extent that the vehicles are used off the reservation.

(G) Property Used in Tribal Self-Governance. Sales and use tax does not apply to sales of tangible personal property to and the storage, use, or other consumption of tangible personal property by the tribal government of an Indian tribe that is officially recognized by the United States if:

1. The tribal government's Indian tribe does not have a reservation or the principal place where the tribal government meets to conduct tribal business cannot be its Indian tribe's reservation because the reservation does not have a building in which the tribal government can meet or the reservation lacks one or more essential utility services, such as water, electricity, gas, sewage, or telephone, or mail service from the United States Postal Service;

2. The property is purchased by the tribal government for use in tribal self-governance, including the governance of tribal members, the conduct of intergovernmental relationships, and the acquisition of trust land; and

3. The property is delivered to the tribal government and ownership of the property transfers to the tribal government at the principal place where the tribal government meets to conduct tribal business.

The purchase of tangible personal property is not exempt from use tax under this paragraph if the property is used for purposes other than tribal self-governance more than it is used for tribal self-governance within the first 12 months following delivery.

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[1] The following is a summary of the pertinent regulations which have been issued:

(a) General. Air force regulation 34-57, issued under date of February 9, 1968, army regulation 210-65, issued under date of May 4, 1966, and navy general order No. 15, issued under date of May 5, 1965, authorize the sale and possession of alcoholic beverages at bases and installations subject to certain enumerated restrictions.

(b) Air Force. Air force regulation 34-57, paragraph 5, permits commissioned officers' and non-commissioned officers' open messes, subject to regulations established by commanders of major air commands to sell alcoholic beverages to authorized purchasers at bars and cocktail lounges, and provides that commanders will issue detailed control instructions. Paragraphs 8 and 9 require commanders of major air commands to issue regulations relative to package liquor sales and to procurement of alcoholic beverages, respectively.

(c) Army. Army regulation 210-65, paragraph 9, provides that major commanders are authorized to permit at installations or activities within their respective commands the dispensing of alcoholic beverages by the drink or bottle. Paragraph 11 of AR 210-65 provides that when authorized by major commanders as prescribed in paragraph 9, AR 210-65, officers' and non-commissioned officers' open messes may, subject to regulations prescribed by the commanding officer of the installation or activity concerned, dispense alcoholic beverages by the drink, and operate a package store.

(d) Navy. Navy general order No. 15 provides that commanding officers may permit, subject to detailed alcoholic beverage control instructions, the sale of packaged alcoholic beverages by officers' and noncommissioned officers' clubs and messes and the sale and consumption of alcoholic beverages by the drink in such clubs and messes.