

1 privilege tax on any of its business activities during the Audit Period. Appellant did file some transaction
2 privilege tax returns during this time, but treated all receipts as exempt sales. Subsequently, the
3 Department assessed Appellant tax, with penalties and interest, on its proceeds from the gift shop,
4 restaurant and hotel operations.¹ The Department did not include the grocery store, laundromat, gas
5 station, or auto repair shop in the audit. During the administrative proceedings, portions of the interest
6 accrued due to delays by the Department were waived, and all penalties were abated. Appellant now
7 timely appeals the remaining tax and interest to this Board.

8 DISCUSSION

9 The specific issue before the Board is whether Arizona may tax the gross proceeds of sales of a
10 federally licensed Indian Trader operating a Reservation business on the Hopi Reservation near the
11 Navajo Reservation and the Navajo-Hopi Joint Use Area.

12 To determine whether a state has authority over the conduct of non-Indians engaged in activities
13 on an Indian Reservation, courts engage in " a particularized inquiry into the nature of the state, federal
14 and tribal interests at stake, an inquiry designed to determine whether, in the specific context, the
15 exercise of state authority would violate federal law." *Arizona Dep't of Rev. v. Dillon*, 170 Ariz. 560, 564,
16 826 P.2d 1186, 1190 (App. 1992) (quoting *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 144-
17 45 (1980)). "State jurisdiction is preempted by the operation of federal law if it interferes or is
18 incompatible with federal and tribal interests reflected in federal law, unless the state interests at stake
19 are sufficient to justify the assertion of state authority." *Arizona Dep't of Rev. v. M. Greenberg Constr.*,
20 182 Ariz. 397, 401, 897 P.2d 699, 703 (App. 1995) (quoting *New Mexico v. Mescalero Apache Tribe*, 462
21 U.S. 324, 334 (1983)).

22 Appellant argues that Arizona is preempted from applying the tax at issue by the comprehensive
23 federal regulations dealing specifically with businesses located within the Navajo and Hopi Reservations²

24
25 ¹ The Department assessed tax on 100% of the gift shop receipts, 100% of the hotel receipts attributable to guests listed with an address off the Hopi Reservation, and 50% of the receipts of the restaurant.

² The federal regulations also apply to the Zuni Indians and their reservation.

1 and the extensive involvement of the federal government in the resolution of the Navajo-Hopi land
2 dispute.

3 In 1975, in recognition of the unique socioeconomic conditions facing the Navajo and Hopi (and
4 Zuni) Reservations, the federal government revised existing Indian Trader regulations and promulgated
5 new regulations to provide a comprehensive regulatory scheme for business activities conducted within
6 the exterior boundaries of these reservations. See 40 Fed. Reg. 39835 (Aug. 29, 1975). In general, the
7 regulations define "reservation business" broadly to mean any business with a fixed location or site within
8 the exterior boundaries of the Navajo, Hopi (or Zuni) reservations that engages in "the sale or purchase of
9 goods or services or in consumer credit transactions with Indians" 25 CFR 141.3(1) (formerly, 25
10 CFR Part 252.3(1)). The regulations apply broadly to all business transactions and are not limited to
11 transactions with "affiliated Indians."

12 Among other things, the extensive regulations restrict the location and nature of business
13 transactions (e.g., Sec. 141.21), prohibit trading in imitation Indian crafts (141.27), regulate prices of
14 goods sold and require that prices be clearly marked (141.16, 141.55), and otherwise regulate trade
15 between Reservation businesses and Indian and non-Indian customers. The regulations require
16 Reservation businesses to pay a license fee (Sec. 141.10), and specifically and expressly allow for
17 regulation and taxation by the tribes (Sec. 141.11). In Appellant's case, the business pays the license fee
18 required by federal regulation and a separate license fee (based on volume of sales) to the Hopi Tribe.
19 The federal regulations contain no provision permitting or recognizing the ability of states to impose taxes.

20 In the Indian "smokeshop" cases, where the courts have upheld the state taxation of cigarette
21 sales, the courts have clearly stated that the interests of the tribe and the federal government were
22 minimal because the operation of the business was unrelated to the activities of the Indian community.
23 See, e.g., *Arizona Dep't of Rev. v. Dillon*, 170 Ariz. 560, 826 P.2d 1186 (App. 1992). These cases deal
24 with "magnet" cigarette operations in which there was no reservation-based value added to the product
25 that was marketed to non-Indians. As the U.S. Supreme Court noted in *Dillon*, "[i]t is painfully apparent
that the value marketed by the smokeshops to persons coming from outside is not generated on the

1 reservations by activities in which the Tribes have a significant interest . . . What the smokeshops offer
2 these customers, and what is not available elsewhere, is solely an exemption from state taxation." 170
3 Ariz. at 569, 826 P.2d at 1195 (quoting *Washington v. Confederated Tribes of the Colville Reservation*,
4 447 U.S. at 154-55, 156-57, 100 S.Ct. at 2081-82, 2083 (1980)).

5 The Court applied the principle of the smokeshop cases to similarly uphold the imposition of
6 Arizona sales and rental taxes on sales and rentals by non-Indian businesses to non-Indians at a
7 shopping mall on a reservation, finding that "the community's activities did not contribute to the goods
8 sold, and . . . Arizona provide[d] most of the governmental services used by the non-Indian taxpayers."
9 *Salt River Pima-Maricopa Indian Community v. Ariz.*, 50 F.3d 734, 736 (9th Cir.), cert. denied, 516 U.S.
10 866, 116 S.Ct. 186 (1995).

11 In a case involving Arizona's taxation of room rentals and food and beverage sales of a hotel
12 located on the reservation of the Yavapai-Prescott Indian Tribe, the U.S. Court of Appeals examined the
13 Tribe's "active role' in the creation of the value taxed in order to establish preemption." *Yavapai-Prescott*
14 *Indian Tribe v. Scott*, 117 F.3d 1107, 1112 (9th Cir. 1997). In the *Yavapai-Prescott* case the Court ruled
15 against preemption, pointing at the fact that (1) all sales were by non-Indians to non-Indians; (2) there
16 was no tribal employment; (3) there was no active tribal participation in the business; and, the State
17 provided substantial governmental services to the business being taxed. *Id* (noting that these factors
18 were decisive in the *Salt River Pima-Maricopa Indian Community v. Ariz.*, 50 F.3d 734 (9th Cir.) cert.
19 denied, 516 U.S. 866, 116 S.Ct. 186, (1995) and *Gila River Indian Community v. Waddell*, 91 F.3d 1232
20 (9th Cir. 1996) cases to which the Court looked for guidance).

21 The Hopi Indian Tribe owns the trading post complex at issue in this appeal. It merely leases its
22 use to Appellants and retains a residual interest in the assignment of the lease. The fee to the land upon
23 which the trading post is built is held in trust for the tribe by the federal government. All employees at the
24 trading post complex are members of either the Hopi Tribe or of the Navajo Nation. A significant number
25 of customers of the trading post complex are members of the Hopi Tribe or of the Navajo Nation. The
retail goods sold by Appellant consist almost entirely of items made by Hopi and Navajo artists; and either
the Hopi Tribe or the federal government provide all of the governmental services for the Keams Canyon
community.

1 Applying the factors of the cases cited above, the Board concludes that there exist enough
2 factors favoring preemption to conclude that the imposition of the Arizona transaction privilege tax upon
3 the business activities of Appellants is invalid.

4 CONCLUSIONS OF LAW

5 Arizona is preempted from imposing the tax at issue. See, *Arizona Dep't of Rev. v. Dillon*, 170
6 Ariz. 560, 564, 826 P.2d 1186, 1190 (App. 1992) *Arizona Dep't of Rev. v. M. Greenberg Constr.*, 182 Ariz.
7 397, 401, 897 P.2d 699, 703 (App. 1995) 40 Fed. Reg. 39835 (Aug. 29, 1975); *Yavapai-Prescott Indian*
8 *Tribe v. Scott*, 117 F.3d 1107 (9th Cir 1997).

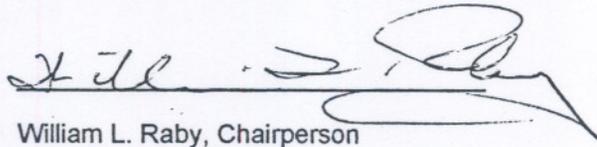
8 ORDER

9 THEREFORE, IT IS HEREBY ORDERED that the appeal is granted, and the final order of the
10 Department is vacated.

11 This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer,
12 unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

13 DATED this 21 day of October, 2004.

14 STATE BOARD OF TAX APPEALS

15
16 
17 William L. Raby, Chairperson

18 WLR:ALW

19 CERTIFIED

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