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9 UNITED STATES DISTRICT COURT

10 CENTRAL DISTRICT OF CALIFORNIA, EASTERN DIVISION

11 TWENTY-NINE PALMS BAND OF
 12 MISSION INDIANS, a federally
 recognized Indian Tribe,

13 Plaintiff,

14 v.

15 ARNOLD SCHWARZENEGGER, , in
 16 his official capacity as Governor of the
 State of California; THE STATE OF
 17 CALIFORNIA; SELVI STANISLAUS
 in her official capacity as Executive
 18 Officer of the Franchise Tax Board,

19 Defendants.
 20

Case No. EDCV08-1753 VAP (OPx)

**OPPOSITION TO MOTION TO
 DISMISS AMENDED COMPLAINT**

The Hon. Virginia A. Phillips

Date: August 3, 2009
 Time: 10:00 a.m.
 Crtrm.: 2

[Complaint Filed: 12/2/2008]

Trial Date: n/a

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1 I. INTRODUCTION

2 This case involves a challenge to the State of California's (the
3 "State's") unlawful imposition of personal income tax on the per capita gaming
4 distributions and income earned by Tribal members from on-reservation activities.¹
5 The imposition of personal income tax constitutes a breach of contract, interferes
6 with tribal sovereignty, and is preempted by federal law. In addition, the income is
7 exempt under state and federal law. The claims for relief in the Amended
8 Complaint are more than sufficient to survive defendants' motion to dismiss.²

9 The Court has jurisdiction over this action. The Twenty-Nine Palms
10 Band of Mission Indians (the "Tribe") has sued the State as well as Arnold
11 Schwarzenegger, in his official capacity as governor of the State of California, and
12 Selvi Stanislaus, in her official capacity as executive officer of the Franchise Tax
13 Board ("FTB"), for prospective relief. Because both Schwarzenegger and Stanislaus
14 are sued in their official capacity and have ties to enforcement of the personal
15 income tax imposed on the Tribe's members, Ex Parte Young applies and the Tribe
16 has standing. The State concedes it has consented to jurisdiction in federal court.

17 The first claim for breach of tribal compact is essentially a claim for
18 breach of contract. Defendants seek dismissal of this claim based upon their
19 preferred interpretation of the meaning of the tribal compact. The Tribe strongly
20 disputes defendants' interpretation. This issue cannot be resolved on a motion to
21 dismiss since the interpretation of the meaning of a contract necessarily entails the
22 introduction of and consideration of various types of extrinsic evidence relating to
23 the making of the contract and its intended meaning.

24 _____
25 ¹ Tribal members are required by federal law to pay federal income tax.

26 ² Defendants' motion to dismiss fails to comply with Local Rule 11-3.1.1 in
27 that the proportionally spaced font is smaller than 14 point. Because the
28 memorandum of points and authorities is 30 pages even with the reduced font, the
brief exceeds this Court's order allowing the parties to exceed the standard page
limitation.

1 The second claim for federal preemption and third claim for exemption
 2 under federal and state law are also proper because the facts alleged in the Amended
 3 Complaint are more than sufficient to establish a set of facts under which the Tribe
 4 is entitled to relief. As detailed below, these claims implicate important federal
 5 rights with the explicit goal and purpose of protecting the sovereignty and self-
 6 governance of Indian tribes. The legal issues are highly complex and require the
 7 consideration of significant extrinsic evidence such as what land the Tribe has, why
 8 its members cannot reside on it, and how the Tribe and its self-governance will be
 9 impacted if state income taxes are allowed to continue. These issues cannot be
 10 resolved on a motion to dismiss and defendants have provided no authority which
 11 would support such a result.³

12 II. STANDARD FOR A MOTIONS TO DISMISS

13 Defendants' motion is based upon both Rule 12(b)(1) and 12(b)(6). In
 14 connection with a Rule 12(b)(1) motion, a court must accept as true all material
 15 allegations in the complaint. Wilbur v. Locke, 423 F.3d 1101, 1107 (9th Cir. 2005).
 16 A court must "draw all reasonable inferences from them in [plaintiff's] favor" in
 17 ruling on a jurisdictional challenge. Valentin v. Hospital Bella Vista, 254 F.3d 358,
 18 361 (1st Cir. 2001).

19 In deciding a motion to dismiss based upon Rule 12(b)(6), a court must
 20 accept all facts as true. Cahill v. Liberty Mutual Ins. Co., 80 F.3d 336, 337-338 (9th
 21 Cir. 1996). From a procedural standpoint, Rule 12(b)(6) motions are disfavored.

22 _____
 23 ³ The reality that there are significant disputed facts which must be developed,
 24 considered, and weighed is borne out by defendants entirely improper and
 25 inadmissible attempt to seek judicial notice of "facts" in state court pleadings in a
 26 case involving different parties and issues. (See Ross Decl., ¶¶ 2-4 ; Objection to
 27 Request for Judicial Notice.) Defendants attempt to use these pleadings as evidence
 28 regarding what land the Tribe has and whether the Tribe's members are really
 precluded from living on the reservation. Taking into account the Tribe's entire
 reservation, significantly less land was reserved for the Tribe than other tribes.
 Nevertheless, by making these arguments, defendants are implicitly admitting that
 the resolution of the "off reservation" issue requires extrinsic evidence thereby
 precluding defendants' motion to dismiss.

1 "The motion to dismiss for failure to state a claim is viewed with disfavor and is
2 rarely granted." Gilligan v. Jamco Dev. Corp., 108 F.3d 246, 249 (9th Cir. 1997);
3 United States v. Redwood City, 640 F.2d 963, 966 (9th Cir. 1981) (12(b)(6)
4 dismissal is proper only in "extraordinary" cases). Rather, "a complaint should not
5 be dismissed for failure to state a claim unless it appears beyond doubt that the
6 plaintiff can prove no set of facts in support of his claim which would entitle him to
7 relief." Conley v. Gibson, 355 U.S. 41, 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957).

8 III. FACTUAL BACKGROUND

9 The Twenty-Nine Palms Band of Mission Indians is an Indian tribe that
10 is federally recognized by the Secretary of the Interior of the United States of
11 America. (Amended Complaint ¶ 6.) The Tribe is quite small. It has only 12
12 members who are over 18 years of age. (Amended Complaint ¶ 11.) Pursuant to the
13 Indian Gaming Regulatory Act of 1988 ("IGRA"), the Tribe and the State entered
14 into the Tribal-State Gaming Compact regarding Class III Gaming (the "Compact").
15 (Amended Complaint ¶ 13.) The Compact was signed by the governor and ratified
16 by the legislature. (Exhibit 1 to Amended Complaint.) Pursuant to the Compact,
17 the Tribe operates a Class III gaming casino (the "Casino") in Coachella, California
18 on the Tribe's reservation. (Amended Complaint ¶ 13.) The economic viability of
19 the Casino is the lifeblood of the Tribe. (Amended Complaint ¶ 16.)

20 In accordance with IGRA, the Tribe periodically prepares and submits
21 to the federal Bureau of Indian Affairs a detailed financial plan for the Casino that is
22 reviewed, approved and monitored by the federal Bureau of Indian Affairs. This
23 plan is called a revenue allocation plan. (Amended Complaint ¶ 15.) The revenue
24 allocation plan of the Tribe contains detailed funding requirements and financial
25 allocation provisions as required by the Bureau of Indian Affairs and federal law.
26 (Amended Complaint ¶ 15.) The plan dictates and details how the Tribe's net
27 gaming proceeds must be distributed and includes the per capita payments to its
28 members. The plan provides for per capita distributions to members of the Tribe

1 and takes into consideration, among other things, the members' obligations to pay
 2 federal income taxes with respect to the per capita payments made under the
 3 revenue allocation plan. (Amended Complaint ¶ 15.) The revenue allocation plan
 4 does not take into consideration the personal income tax that the State seeks to
 5 impose on the Tribe's members. (Amended Complaint ¶ 15.)

6 The Tribe's reservation is comprised of two separate parcels. Neither
 7 parcel contains any residential housing. (Amended Complaint ¶ 17.) The first
 8 parcel is in Coachella and is taken up entirely by the Casino and Casino parking lot.
 9 (Amended Complaint ¶ 17.) The other parcel is comprised of approximately 92
 10 acres and is located across the Interstate-15 freeway away from the Casino. This
 11 parcel is near a sanitation plant whose effluence flows through a canal next to the
 12 92-acre parcel, thereby making the land unsuitable for homes or the raising of
 13 families. (Amended Complaint ¶ 17.) The Tribe takes the additional off-
 14 reservation housing costs into account when it establishes its payments pursuant to
 15 the revenue allocation plan. (Amended Complaint ¶ 17.)

16 IV. ARGUMENT

17 A. The Court Has Jurisdiction Under the Eleventh Amendment and Ex Parte 18 Young

19 In general, the Eleventh Amendment prohibits parties from suing a
 20 state in federal court. An exception to the Eleventh Amendment was announced by
 21 the Supreme Court in Ex Parte Young, 209 U.S. 123, 160, 28 S. Ct. 441, 52 L. Ed.
 22 714 (1908). The Supreme Court held that state officials who have a connection to
 23 enforcement of the challenged action may be sued in their official capacity in order
 24 to enjoin them from enforcing allegedly unconstitutional laws. Ex Parte Young, 209
 25 U.S. 123. The Ex Parte Young doctrine is a legal fiction that an action is not against
 26 a state and is therefore not subject to the sovereign immunity bar. Agua Caliente
 27 Band of Cahuilla Indians v. Klehs, 223 F.3d 1041, 1045 (9th Cir. 2000). The
 28 “doctrine strikes a delicate balance by ensuring on the one hand that states enjoy the

1 sovereign immunity preserved for them by the Eleventh Amendment while, on the
 2 other hand, ‘giving recognition to the need to prevent violations of federal law.’”
 3 Id., quoting, Idaho v. Coeur d'Alene Tribe of Idaho, 521 U.S. 261, 269, 117 S. Ct.
 4 2028, 138 L. Ed. 2d 438 (1997).

5 Suits for prospective injunctive relief may proceed against individuals
 6 in their official capacities. Capitol Industries-EMI, Inc. v. Bennett, et al, 681 F.2d
 7 1107, 1120 (9th Cir. 1982); AT&T Communications v. Bellsouth Communications
 8 Inc., 238 F.3d 636 (5th Cir. 2001) (action against commissioners of public service
 9 commission); Agua Caliente, 223 F.3d 1041 (action by tribe against state tax
 10 officials). The cases defendants cite are inapposite because they involve contexts in
 11 which the attorney general or other official lacked any connection with the
 12 enforcement of the state law.⁴ In contrast, as explained below, both the executive
 13 officer of the FTB and the governor have direct ties to enforcement of personal
 14 income tax. Because the Tribe seeks only prospective relief, the claims fall within
 15 Ex Parte Young and the Tribe may proceed in federal court.

16 1. The Claims Against Executive Officer Selvi Stanislaw Fall within Ex
 17 Parte Young

18 As a state official with ties to enforcement of the personal income tax
 19 laws, Selvi Stanislaus, executive officer of the FTB, falls within Ex Parte Young.
 20 The Ninth Circuit has already concluded that an action for prospective relief against
 21 the executive officer of the FTB is permissible under Ex Parte Young. Capitol
 22 Industries, supra, 681 F.2d at 1120.

23 Capitol Industries involved a foreign company, EMI Limited, that
 24 owned a group of subsidiaries including Capitol Industries. EMI Limited sued the

25 _____
 26 ⁴ See e.g. Southern Pacific Transportation Co. v. Brown, 651 F.2d 513 (9th Cir.
 27 1980) (attorney general maintained only advisory power); Long v. Van de Kamp,
 28 961 F.2d 151 (9th Cir. 1992) (attorney general maintained only general supervisory
 authority); Snoeck v. Brussa, 153 F.3d 984, 986 (9th Cir. 1998) (members of Nevada
 Commission on Judicial Discipline lacked connection to enforcement).

1 FTB's executive officer and board members to challenge a proposed tax assessment.
2 The FTB argued that the EMI Limited's claim was barred by the Eleventh
3 Amendment. The Ninth Circuit disagreed, stating that the "Eleventh Amendment
4 does not bar federal court actions against state officials to enjoin them from
5 enforcing unconstitutional statutes." *Id.* at 1120. The Ninth Circuit concluded the
6 "case falls squarely within the doctrine of *Ex Parte Young*. In such cases, the
7 Eleventh Amendment does not preclude access to the federal courts." *Id.* at 1120.⁵

8 Here, defendants concede that the FTB is the "sole state agency
9 authorized by state law to administer and enforce the state's Personal Income Tax
10 Law." (Moving Papers, page 9, lines 6-7.) Cal. Rev. & Tax. Code § 19501. The
11 FTB has the power to demand information and require attendance and testimony at
12 hearings for the purpose of administering the personal income tax laws. Cal. Rev. &
13 Tax. Code § 19504. Any power granted to the FTB may be performed by any
14 officer unless expressly provided that the power shall be performed only by the
15 board itself. Cal. Govt. Code § 15702. In fact, almost all of the powers granted to
16 and duties imposed on the FTB may be exercised and performed by the executive
17 officer. 18 Cal. Code Regs. § 17000.10.

18 The executive officer is one of the top-ranking officials of FTB. Cal.
19 Gov't. Code § 15701. The FTB may not impose penalties unless approved in
20 writing by the supervisor of the FTB employee making the determination or a higher
21 level official approved by the executive officer. Cal. Rev. & Tax. Code § 19187.
22 The executive officer is authorized to sign subpoenas upon tax payers for certain tax
23 violations. Cal. Rev. & Tax. Code § 19504(c)(2). The executive officer is directly
24 involved with settlement of lawsuits involving tax issues, including reviewing,
25 recommending and approving settlements. Cal. Rev. & Tax. Code §§ 19442, 19443.

26 _____
27 ⁵ If the Court concludes that FTB's board members are more appropriate
28 defendants than the executive officer, the Tribe requests leave to name the board
members as defendants.

1 Clearly, the executive officer is connected with enforcement of personal income tax
2 within the meaning of Ex Parte Young. As a result, the motion to dismiss Stanislaus
3 pursuant to the Eleventh Amendment must be denied.

4 2. The Claims Against Governor Schwarzenegger Fall Within Ex Parte
5 Young

6 The governor also has authority to enforce and administer issues
7 pertaining to the state's revenues and taxes. The governor not only has general
8 powers of supervision over all financial policies of the state, the governor "shall,"
9 whenever he deems it necessary, institute proceedings to conserve the rights and
10 interests of the State. Cal. Gov't. Code § 13070.

11 The governor's connection to enforcement includes his ability to issue
12 executive orders. An executive order is a plan, requirement, rule or regulation. Cal.
13 Govt. Code § 17516; Cal. Rev. & Tax. Code § 2209. The governor exercises this
14 authority with regard to taxation whenever he deems appropriate. For example, the
15 governor issued Executive Order S1-03, in which he unilaterally rescinded a letter
16 by the Director of Finance regarding vehicle license fees, ordered the Department of
17 Motor Vehicles to reinstate the General Fund to offset the vehicle license fee, and
18 directed the Department of Motor Vehicles to refund to taxpayers these vehicle
19 license fees. The governor further ordered the Department of Motor Vehicles to
20 take any steps necessary to carry out this order. Cal. Exec. Order S-1-03
21 (11/17/2003). The governor also issued Executive Order W-66-93 in which he
22 created a strike force consisting of the FTB and other agencies to target enforcement
23 relating to failure to pay taxes. Cal. Exec. Order W-66-93 (10/26/93). Thus, the
24 governor not only has the authority to enforce issues relating to the state's revenues
25 and taxes, but has exercised that authority. The Ninth Circuit has already concluded
26 that the Eleventh Amendment does not bar a claim against the governor of
27 California relating to breach of contract or improper fees and taxes. Cabazon Band
28 Of Mission Indians v. Wilson, 124 F.3d 1050, 1058-1060 (9th Cir. 1997) ("Cabazon

1 III) . The motion to dismiss the governor under the Eleventh Amendment must be
2 denied.

3 3. There Is No Case Law Barring Jurisdiction

4 Defendants mistakenly rely upon Seminole Tribe of Florida, 517 U.S.
5 44, 47, 116 S. Ct. 1114, 134 L. Ed. 2d 252 (1996) for their assertion that the
6 Eleventh Amendment bars the second and third causes of action. In Seminole, the
7 Supreme Court held that the Indian Commerce Clause does not provide an
8 independent basis for jurisdiction. Because the tribe in that case sued the state itself,
9 the parties did not argue and the Court did not address Ex Parte Young. The Ex
10 Parte Young doctrine serves as an independent basis for federal jurisdiction. AT&T,
11 238 F.3d at 643, 647.⁶ Because this Court has jurisdiction over this action under Ex
12 Parte Young, Seminole is not relevant.

13 B. There Exists A Justiciable Case Or Controversy Between The Tribe And The
14 Governor

15 Three requirements must be met for standing: (1) the plaintiff must
16 have suffered an injury; (2) there must be a causal connection between the injury
17 and the wrongful act; and (3) it must be likely that the injury will be redressed by a
18 favorable decision. Lujan v. Defenders of Wildlife, 504 U.S. 555, 560, 112 S. Ct.
19 2130, 119 L. Ed. 2d 351 (1992). Defendants mistakenly argue that the second and
20 third elements are lacking.

21 The cases upon which defendants rely involve circumstances in which
22 the plaintiffs sued defendants with no ability to correct the wrongful act or where the
23 plaintiffs themselves were not directly injured by the wrongful act. For example, in
24 Simon v. Kentucky Welfare Rights Org., 426 U.S. 26, 96 S. Ct. 1917, 48 L. Ed. 2d
25 252 (1996), the plaintiffs sued the Secretary of the Treasury and the Commissioner
26 of Internal Revenue challenging a revenue ruling that allegedly encouraged hospitals

27 ⁶ Defendants concede that the State has consented to federal jurisdiction as to
28 the breach of contract claim. (Moving Papers, page 18, line 27- page 19, line 2.)

1 to deny services to indigent patients. The Court noted that the implicit corollary is
2 that if the regulation were revised to require hospitals to serve indigent patients to
3 receive favorable tax treatment, hospitals would be discouraged from denying
4 treatment. Simon, 426 U.S. at 42. The Court, however, stated that the denial of
5 access to hospitals did not necessarily relate to the revenue ruling and that it was
6 speculative whether the requested relief would result in indigent patients receiving
7 hospital services. Id. The Court thus concluded that the plaintiffs lacked standing.

8 Defendants also cited to Lujan, which involved the Endangered Species
9 Act's requirement that federal agencies funding projects ensure that the projects are
10 not likely to jeopardize endangered species. The Fish and Wildlife Service and
11 National Marine Fisheries Service promulgated a regulation extending the
12 protection of endangered species to actions taken in foreign nations but later
13 rescinded that regulation. The plaintiffs were wildlife organizations who sued the
14 Secretary of the Interior seeking a declaratory judgment that the new regulation was
15 in error. The Court stated that where “a plaintiff’s injury arises from the regulation
16 (or lack of regulation) of *someone else*, much more is needed” to prove that standing
17 requirements are satisfied. Id. (emphasis in original). The Court found causation
18 lacking because the plaintiff’s asserted injury arose from the government’s unlawful
19 regulation of a third party. Lujan, 504 U.S. at 562. In addition, the Court concluded
20 that redressability was a problem specifically because the agencies funding the
21 projects were not parties to the action. Id. at 568.

22 In contrast to Lujan and Simon, both causation and redressability are
23 satisfied in the present action. Unlike in Lujan, this action does not arise from the
24 regulation of a third party and heightened scrutiny is not necessary. Taking the facts
25 of the complaint as true, the governor signed the Compact promising not to impose
26
27
28

1 personal income taxes on the distributions of Tribal members.⁷ The State, through
 2 the FTB, has been imposing personal income tax. The imposition of personal
 3 income tax breaches the contract and violates federal and state law. The governor
 4 has caused the injury by allowing Tribal members to be taxed. The injury can be
 5 redressed by the governor in a number of ways, including the issuance of executive
 6 orders. As a result, standing is satisfied.

7 C. The Motion To Dismiss Should Be Denied As To The First Claim For Breach
 8 Of Contract Because The Complaint Alleges Facts Upon Which Relief
 9 May Be Granted

10 Dismissal of the first claim for breach of contract is not appropriate
 11 because defendants cannot establish that the Tribe cannot prove any set of facts that
 12 would entitle it to relief. The goal of contract interpretation "is to give effect to the
 13 mutual intent of the parties as it existed at the time of contracting." See United
 14 States Cellular Invest. Co. of Los Angeles v. GTE Mobilnet, Inc., 281 F.3d 929, 934
 15 (9th Cir. 2002); MacKinnon v. Truck Ins. Exch., 31 Cal.4th 635 (2003); see Cal. Civ.
 16 Code § 1636. General principles of contract interpretation apply to gaming
 17 compacts. Idaho v. Shoshone-Bannock Tribes, 465 F.3d 1095, 1098 (9th Cir. 2006).

18 The Tribe alleges that the essence of the Compact is that the Tribe will
 19 pay the State millions of dollars per year in licensing fees and, in return, the Tribe is
 20 to operate the Casino in accordance with the Compact provisions and IGRA.
 21 (Amended Complaint ¶ 18 .) Section 10.3(c) provides:

22 "As a matter of comity, with respect to persons employed
 23 at the Gaming Facility, **other than members of the**
 24 **Tribe**, the Tribal Gaming operations shall withhold all
 25 taxes due to the State as provided in the California

26 ⁷ The fact that Governor Schwarzenegger did not sign the compact is of no
 27 import since he is sued in his official capacity. As the successor, Governor
 28 Schwarzenegger is the appropriate defendant. See Fed. R. Civ. Proc. 25(d);
Mumford v. Basiniski, 105 F.3d 264, 273 (6th Cir. 1997).

1 Unemployment Insurance Code and the Revenue and
 2 Taxation Code, and shall forward such amounts as
 3 provided in said Codes to the State."

4 The intent of the parties and the circumstances at the time the Compact
 5 was signed, including whether Indians were currently being taxed on per capita
 6 distributions and casino income, is relevant to the interpretation. When the Compact
 7 was entered into, the State knew that per capita payments from tribal gaming would
 8 be heavily supervised by the federal government, pursuant to the revenue allocation
 9 plan. The State knew the per capita payments would include a portion for members'
 10 living expenses. The State knew that the federal Bureau of Indian Affairs would be
 11 in control of the revenue allocation plan payments and would only be considering
 12 federal income taxes. The State also knew that no Tribal members lived on the
 13 Tribe's reservation. Thus, the parties included the language in § 10.3(c) in the
 14 Compact, exempting the members from personal income tax. Section 10.3(c), taken
 15 as a whole and in the context in which it was negotiated, constituted a negotiated
 16 elimination of state income taxes for Tribal members' income derived from
 17 employment with the Casino and for per capita distributions pursuant to the revenue
 18 allocation plan. The State may not trump all of the overwhelming evidence here
 19 regarding the intent of the Compact through a motion to dismiss.

20 Defendants disagree with the Tribe's interpretation of the contract,
 21 asserting that Section 10.3(c) refers to the Tribe's voluntary assumption to withhold
 22 state income taxes from the wages of **nonmember** gaming facility employees.
 23 Defendants argue that a tribe may be required to collect taxes on its reservation from
 24 **nonmember** Indians even absent a compact.⁸ This point merely supports the Tribe's

25 _____
 26 ⁸ In support of this statement, defendants mistakenly rely upon California State
 27 Bd. Of Equalization v. Chemehuevi Indian Tribe, 474 U.S. 9, 11-12, 106 S. Ct. 289,
 28 88 L. Ed. 2d 9 (1985) (tribe required to collect sales tax on non-Indians who
 purchase cigarettes) and Washington v. Confederated Tribes of Colville Indian
 Reservation, 447 U.S. 134, 151, 100 S. Ct. 2069, 64 L. Ed. 2d 10 (1980) (same).

1 argument – if the Tribe is already required to collect taxes on behalf of the State,
2 Section 10.3(c) is meaningless. Moreover, this dispute is about income to member
3 Indians under the compact.

4 The defendants have presented no legal authority supporting their
5 contract interpretation. Neither Cabazon III, *supra*, 124 F.3d 1050, 1058-1060 nor
6 any other case cited by defendants provides that a commitment in a compact must be
7 explicit rather than implied. In fact, the opposite is true. Cabazon III provides that
8 state authority over class III gaming is limited by the explicit terms of the applicable
9 Compact. Cabazon III, 124 F.3d at 1060.

10 The other cases cited by defendants are taken out of context. In
11 Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 52,
12 106 S. Ct. 2390, 91 L. Ed. 2d 35 (1986), various groups challenged Congress's
13 amendment to the Social Security Act prohibiting states from withdrawing from the
14 social security system (terminating their contracts) after a certain date. In the
15 excerpt quoted by defendants, the Court simply stated that courts should be reluctant
16 to conclude that Congress lacked the right to amend the Act. In United States v.
17 Winstar Corp., 518 U.S. 839, 878-879, 116 S. Ct. 2342, 135 L. Ed. 2d. 964 (1986),
18 the Court concluded that the federal government's promise to forever refrain from
19 regulatory changes must appear absolutely clear to be enforceable. This principle
20 has no application to a contract signed by a state for a limited number of years that
21 does not contain a promise to refrain from ever making regulatory changes.

22 The meaning of Section 10(c) in the Compact is not one that can be
23 decided in a motion to dismiss. It is a factual issue for the Court. Defendants'
24 motion to dismiss as to the first claim, therefore, must be denied.

25 D. The Motion Must Be Denied As To The Second And Third Claims Because
26 State Personal Income Taxes Interfere With Tribal Sovereignty And Are

27 These cases are not relevant to whether the State contractually agreed to forego
28 personal income tax.

1 Preempted By IGRA

2 1. The State Personal Income Taxes Interfere With Tribal Sovereignty

3 Congress has broad power to regulate tribal affairs under the Indian
4 Commerce Clause, Art. 1, § 8, cl. 3. See United States v. Wheeler, 435 U.S. 313,
5 322-323, 98 S. Ct. 1079, 55 L. Ed. 2d 303 (1978). The exercise of state authority
6 may be barred by inherent tribal sovereignty if it unlawfully infringes on the right of
7 Indians to make their own laws and be ruled by them.⁹ New Mexico v. Mescalero
8 Apache Tribe, 462 U.S. 324, 334, 103 S. Ct. 2378, 76 L. Ed. 2d (1953). "[T]ribal
9 sovereignty is dependent on, and subordinate to, only the Federal Government, not
10 the States" California v. Cabazon Band of Indians, 480 U.S. 202, 107 S.Ct. 1083,
11 94 L. Ed. 2d 244 (1987), citing, Washington v. Confederated Tribes of Colville
12 Indian Reservation, 447 U.S. 134, 154, 100 S. Ct. 2069, 2082, 65 L. Ed. 2d 10
13 (1980). Once the federal government recognizes a tribe as a political body, the tribe
14 retains its sovereignty until Congress divests it of that sovereignty. Cohen's
15 Handbook of Federal Indian Law (2005) § 4.01[1][a]. Where the state seeks to tax
16 Indian activities on reservation land, courts consider traditional notions of Indian
17 sovereignty and the congressional goal of Indian self-government, including its
18 overriding goal of self-sufficiency and economic development. Cabazon Band of
19 Indians, 480 U.S. at 216 (1987). While Congress has the power to authorize the
20 imposition of state taxes over Indians, the courts will find the Indians exempt **unless**
21 **Congress has expressly authorized the tax.** Cabazon Band of Indians 480 U.S. at
22 216, fn. 17. Congress has not authorized the imposition of personal income tax on
23 per capita gaming distributions.

24 In Oklahoma Tax Commission v. Chickasaw Nation, 515 U.S. 450, 115
25 S. Ct. 2214, 132 L. Ed. 2d 400 (1995), the Supreme Court held that a member of an
26 Indian tribe, living off his reservation, could be taxed on Casino employment

27 ⁹ Tribal sovereignty and federal preemption are related but independent barriers
28 to the assertion of state authority. Bracker, 448 U.S. at 142.

1 income by the state in which he was domiciled. However, Justice Ginsburg, in
2 writing the majority (5 to 4) opinion, qualified the decision as follows: "**Notably,**
3 **the tribe has not asserted here, or before the Court of Appeals that the state's**
4 **tax infringes on tribal self-governance.**" *Id.* at 465 (emphasis added). Thus,
5 infringement on tribal sovereignty was not considered in that decision. Here, the
6 Tribe has asserted, based upon the unique facts presented, that personal income tax
7 on its members does impose a significant infringement upon its self-governance.

8 The State's imposition of personal income tax infringes upon tribal
9 sovereignty because it forces the Tribe to rearrange the way the Tribe operates the
10 Casino and uses the reservation land to accommodate the personal income tax.
11 Unlike many tribes, the Tribe's reservation contains no housing and is not suitable
12 for housing. The Tribe's revenue allocation plan includes an amount for living
13 expenses, including housing. Imposing personal income tax on the members
14 disrupts tribal sovereignty in a number of ways including dictating how the Tribe
15 operates the Casino and allocates its land. It places the Tribe in a dilemma: Does it
16 now have to rearrange the structure and organization of the Casino or parking lot to
17 build some type of housing in order to avoid personal income tax? If the Tribe uses
18 the parking lot or Casino space for housing, how does it makeup for the lost income
19 considering that without the Casino, the Tribe has no revenue? Does it have to try
20 and build some type of housing for members on the other small plot of land next to
21 the sewer treatment plant to avoid personal income tax? If so, how will this affect
22 the health and safety of the members? How will this affect the schooling of the
23 members' children? Both of these Hobson's choices will result in substantial
24 disruption and distraction of Tribal governance for years to come. The zoning and
25 environmental issues which the Tribe would be required to deal with would be
26 immense. The reservation is the Tribe's land and the Tribe would have to deal with
27 all of the regulatory authorities if it is required to build housing for its members on
28 the small reservation in order for them to avoid personal income tax.

1 Tribal sovereignty is also infringed because imposition of personal
2 income tax directly impacts the way in which the Tribe allocates and adjusts its
3 revenue allocation plan distributions. The Tribe must revise its revenue allocation
4 plan to account for the personal income tax. The interference that the personal
5 income tax has on tribal sovereignty is akin to the state forcing Congress to amend
6 the federal budget. The State is not entitled to interfere with this tribal sovereignty.

7 2. The State Personal Income Tax Is Preempted by IGRA

8 a. The State's Limited Interests Are Outweighed By Strong Federal
9 And Tribal Interests

10 The Supreme Court has rejected the proposition that a state law is only
11 preempted if there is an express congressional statement to that effect. White
12 Mountain Apache Tribe v. Bracker, 448 U.S. 136, 144, 100 S. Ct. 2578, 65 L. Ed.
13 2d 665 (1980); Cabazon Band of Mission Indians v. Wilson, 37 F.3d 430, 432 (9th
14 Cir. 1994) ("Cabazon II"). Where the federal government heavily regulates an area,
15 courts do not apply mechanical conceptions but must make a "particularized inquiry
16 into the nature of the state, federal and tribal interests at stake, an inquiry designed
17 to determine whether, in the specific context, the exercise of state authority would
18 violate federal law." Bracker, 448 U.S. 136, 148.

19 In determining whether federal law preempts state activity on tribal
20 lands, courts use different standards than with other areas of federal preemption.
21 Cabazon II, 37 F.3d at 432. State authority is preempted if it "interferes with or is
22 incompatible with federal and tribal interests reflected in federal law, unless the
23 state interests at stake are sufficient to justify the assertion of state authority."
24 Cabazon II, 37 F.3d at 433; New Mexico v. Mescalero Apache Tribe, 462 U.S. 324,
25 334, 103 S. Ct. 2378, 76 L. Ed. 2d 611 (1983). In balancing these interests, there is
26 no need for congress to explicitly announce that a state activity is preempted. Crow
27 Tribe of Indians v. Montana, 819 F.2d 895, 898, aff'd, 484 U.S. 997 (1988).
28 "Ambiguities in federal law are, as a rule, resolved in favor of tribal independence."

1 Cabazon II, 37 F.3d at 432, quoting, Cotton Petroleum v. New Mexico, 490 U.S.
2 163, 177, 109 S. Ct. 1698, 104 L. Ed. 2d 209 (1989).

3 For example, in Bracker, the state of Arizona attempted to impose its
4 motor carrier license tax and fuel tax on a non-Indian logging company operating on
5 a reservation. The Supreme Court noted the detailed set of regulations governing
6 the harvesting and sale of tribal timber. Bracker, 448 U.S. at 145. The Court
7 concluded that there was no room for the state taxes within the pervasive federal
8 regulatory scheme. Accordingly, the Court held the state taxes were preempted.
9 The Court stated that the imposition of taxes would obstruct federal policies. The
10 Court also noted it was unable to identify any regulatory function or service
11 performed by the state that would justify the tax. Id. at 148. Accordingly, the Court
12 concluded the tax was preempted.

13 Following Bracker, the Ninth Circuit concluded that IGRA preempted
14 state law. Cabazon II, supra, 37 F.3d 430. In Cabazon II, two Indian bands filed a
15 lawsuit against the governor and the state of California challenging the state's
16 authority to collect taxes for simulcast wagering (offtrack betting) on the
17 reservation.¹⁰ The bands were conducting the offtrack betting pursuant to IGRA and
18 a compact negotiated between the state and each band. Id. at 432. The Ninth
19 Circuit analyzed whether Congress preempted the extension of state authority onto
20 Indian reservations by implication by reviewing the federal, tribal and state interests.

21 Analyzing the federal interests, the Ninth Circuit explained that the text
22 of IGRA sets forth those federal interests. IGRA is intended to "promot[e] tribal
23 economic development, self-sufficiency, and strong tribal interests." 25 U.S.C.
24 § 2701(1). IGRA also seeks to ensure that the Indian tribe is the primary beneficiary
25 of the gaming operation. Id. at 433, citing, 25 U.S.C. §§ 2701(1) and (2). Because

26 _____
27 ¹⁰ Although the tax was called a "license fee," the state conceded that it was a
28 true "tax." Cabazon II, 37 F.3d at 432.

1 the State received more in taxes from offtrack betting than the bands, the Ninth
2 Circuit concluded that the taxes threatened the federal interests because the tribes
3 were not the primary beneficiary.¹¹

4 Analyzing the tribal interests, the Ninth Circuit concluded that the tax
5 falls directly upon the racing association but that the bands bear the actual burden of
6 the tax. The court considered the nature of the taxed activity. *Id.* at 434. Although
7 the offtrack betting involved activity off the reservation, the value came from within
8 the reservation borders. The bands made a substantial investment in the gaming
9 operations and were not merely conduits for others.

10 Analyzing the State's interests, the Ninth Circuit noted that those
11 interests were weaker than the federal and tribal interests. The State's interest was
12 weakened because "IGRA specifically recognizes such state regulation and
13 establishes a mechanism -the compacts- by which the bands can reimburse the state
14 for regulatory costs, outside of the state tax structure." In addition the court required
15 that the state demonstrate a close relationship between the tax imposed on
16 reservation activity and the state interest asserted to justify the tax. *Id.* at 435. The
17 Ninth Circuit concluded that the express objectives of IGRA, when combined with
18 the tribes' interests, precluded the application of the tax. *Id.*

19 b. State Income Taxes of Per Capita Distributions Conflict With
20 IGRA

21 Here, as in *Bracker*, IGRA is a comprehensive scheme governing the
22 revenue allocation plans, tribal distributions, and how the distributions are allocated.
23 25 C.F.R. 290 *et. seq.* In accordance with IGRA regulations, tribes prepare a
24 revenue allocation plan which are approved and monitored by the federal
25 government. 25 C.F.R. § § 290.5, 290.19, 290.20. IGRA's regulations dictate
26 exactly how gaming revenue proceeds are to be allocated, including funding tribal

27 ¹¹ IGRA requires distributions to be distributed out for particular purposes in a
28 particular way.

1 programs, providing for the general welfare of the Tribe or its members, and
2 donating to charitable organizations. 25 C.F.R. § 290.12. The revenue allocation
3 plan must specify precise percentages that will be devoted to each. 25 C.F.R.
4 § 290.12(a). The Tribe, in its revenue allocation plan, must specify who receives the
5 per capita distribution. 25 C.F.R. § 290.14. Where the federal government heavily
6 regulates an area, the court must make a "particularized inquiry into the nature of the
7 state, federal and tribal interests at stake, an inquiry designed to determine whether,
8 in the specific context, the exercise of state authority would violate federal law."
9 Bracker, 448 U.S. 136, 148. As in Bracker, the area of law is so heavily regulated
10 that it is preempted by IGRA.

11 Balancing the federal, tribal, and state interests, it becomes clear that
12 IGRA preempts state income tax of per capita distributions. The federal interests
13 include to "promot[e] tribal economic development, self-sufficiency, and strong
14 tribal interests." 25 U.S.C. § 2701. The imposition of state income taxes
15 undermines these goals. The Tribe drafted its own revenue allocation plan, tailored
16 to the Tribe's needs, and submitted the plan to the federal government for review
17 and approval. The revenue allocation plan contains details regarding how all of the
18 Tribe's net gaming proceeds from tribal activities will be distributed. 25 C.F.R.
19 §§ 290.4, 290.12. The federal government then approved the plan. (65 Fed. Reg.
20 No. 53, p. 14461 (March 17, 2000); 25 C.F.R. §§ 290.2, 290.5.)

21 The Tribe's plan does not take into consideration the substantial
22 personal income tax that the State is seeking to impose on the Tribe's members.
23 Should these taxes be permitted to continue, the Tribe will be forced to revise the
24 distribution of the gaming revenues and the percentages in order to accommodate
25 the personal income tax. IGRA and its regulations create a comprehensive scheme
26 for review and approval of a revenue allocation plan and specifically identify the
27
28

1 conditions for per capita distributions.¹² The Bureau of Indian Affairs monitors and
2 approves the Tribe's revenue allocation plan in accordance with detailed federal
3 requirements with an understood amount of tax burden. The State's effort to levy
4 personal income taxes directly disrupts this detailed federal scheme.

5 Moreover, given the complex facts of this case, the personal income tax
6 creates a substantial infringement on Tribal sovereignty, governance and
7 independence. There is nothing more critical to Tribal self-governance than housing
8 and its sole source of revenue, which must be distributed in a way dictated by the
9 federal government. The Tribe's revenue allocation plan is expressly designed to
10 enhance the general welfare of the Tribe and its members and to enable them to
11 attain economic assistance from government assistance programs. Here, the
12 personal income tax has a dramatic, negative impact on Tribal self-government. It
13 has the potential of creating havoc in the way the Tribe can use its very limited land
14 and resources. If the personal income tax is permitted to continue, the Tribal
15 Council's activities could be consumed by addressing financial, environmental,
16 regulatory and other issues involving housing on the reservation.

17 In assessing the Tribe's interest, it is also important to consider the
18 nature of the activity taxed. Cabazon II, 37 F.3d at 434. Here, the activity involves
19 Tribal member per capita distributions, pursuant to IGRA, and income earned by
20 tribal members from work performed on the reservation. Thus, the State is taxing
21 income earned exclusively on the reservation. The legal incidence and the burden of
22 the tax fall directly on the Tribe and its members.

23 The State's interests, however, are relatively weak. IGRA specifically
24 contemplates federal taxation but not imposition of personal income tax. 25 U.S.C.
25 § 2710(b)(c)(D) and 2710 and 2710(d)(4). The State does not have a strong interest

26 ¹² Per capita distributions are only permissible if certain requirements are
27 fulfilled, including the tribe's preparation of a revenue allocation plan, federal
28 approval of that plan, and that the payments are subject to federal taxation. 25
U.S.C. § 2710(b)(3).

1 in taxing per capita distributions or Tribal members' income earned by working at
 2 the Casino. Instead, the State merely wants to tax because it can. This is hardly a
 3 sufficient justification for interfering the IGRA's comprehensive structure.

4 While the court in Jefferson v. Comm'r of Revenue, 631 N.W.2d 391
 5 (2001) concluded that IGRA did not preempt Minnesota state income tax, this
 6 decision is neither binding nor persuasive on this court.¹³ The Minnesota court
 7 concluded that state taxation may not be preempted unless expressly preempted by
 8 Congress. Id. at 396. This approach blatantly conflicts with the law of the Ninth
 9 Circuit and the Supreme Court. As explained in Cabazon II, the "Supreme Court
 10 has, as a matter of federal Indian law, explicitly rejected the proposition that in order
 11 to find a particular state law to have been preempted by operation of federal law, an
 12 express congressional statement to that effect is required." Cabazon II, 37 F.3d at
 13 431, quoting Bracker, 448 U.S. 136, 144. Instead, courts employ the balancing
 14 approach referenced above. Under that approach, the interests of the Tribe and the
 15 federal government significantly outweigh the interest of the state. Accordingly, the
 16 personal income tax is preempted.

17 3. The Supreme Court Precedent Precluding Taxation of Indians In Indian
 18 Country Does Not Dictate The Outcome Of This Case

19 Defendants may not hide behind McClanahan v. Arizona Tax
 20 Commission, 411 U.S. 164, 93 S. Ct. 1257, 36 L. Ed. 2d 129 (1972) in order to
 21 avoid the Tribe's claims. In McClanahan, the Supreme Court concluded that states
 22 may not impose income taxes on tribal members where the source of the individual's
 23 income is from reservation activities if the Indian lives in "Indian Country."
 24 McClanahan deals only with whether the state may tax Indians in Indian Country
 25 and does not address the issues and circumstances posed by the Amended

26 ¹³ In Jefferson, importantly, the tribal member did not provide any evidence or
 27 argument as to the state income tax infringing upon tribal sovereignty. The court
 28 suggested that the result could be different if such evidence had been provided.
Jefferson, 631 N.W.2d at 397.

1 Complaint. Defendants' argument that the members of the Tribe do not live on the
2 reservation, therefore, misses the mark. Neither the Supreme Court nor the Ninth
3 Circuit have addressed whether income and per capita distributions from gaming
4 activities pursuant to IGRA and a tribal compact are subject to state income taxes.

5 4. There Are Extensive Factual Issues Which Preclude Granting A Motion
6 To Dismiss

7 Given the highly unique circumstances of this case, the extremely
8 strong federal policies in favor of Tribal sovereignty and self-governance, including
9 the Tribe's revenue allocation plan (which is outside the scope of this motion to
10 dismiss), and the series of Hobson's choices if the Tribe is required to re-allocate its
11 usable property or develop its unusable property, numerous factual issues are raised
12 by this motion. These issues will, in turn, directly impact the Tribe's self-
13 governance. All of these issues require evidence from which this Court may then
14 determine whether the Tribal members' income from reservation activities is
15 immune from state income taxation notwithstanding the fact they do not live on the
16 reservation. Because extrinsic evidence is required to answer these questions,
17 defendants' motion to dismiss at the pleading stage must be denied.

18
19 E. The Motion To Dismiss As To The Third Claim Should Be Denied Because
20 The Gaming Revenue Is Exempted From Personal Income Tax Based On Its
21 Classification As A Partnership.

22 1. The Operation Is A Partnership for Purposes of California Personal
23 Income Tax

24 The Amended Complaint alleges that the "operation of gaming on the
25 Reservation by the Tribe, the Tribal Corporation and its Members to produce
26 Class III Gaming Income (the "Operation") is a business, financial operation or
27 venture." (Amended Complaint, ¶32.) Both federal and California regulations
28 provide that the Operation may be classified as a partnership for income tax

1 purposes even though the Operation itself is not a separate legal entity for non-tax
2 purposes. Section 23038(b)-1 of Title 18 of the California Code of Regulations,
3 provides in part as follows:

4 Whether an organization is an entity separate from its
5 owners for California income and franchise tax purposes is
6 a matter of California income and franchise tax law and
7 does not depend on whether the organization is recognized
8 as an entity under local law. . . . A joint venture or other
9 contractual arrangement may create a separate entity for
10 California income and franchise tax purposes if the
11 participants carry on a trade, business, financial operation,
12 or venture and divide the profits therefrom. . . .

13 The quoted language is identical to the corresponding provisions of
14 United States Treasury Department Regulations § 301.7701-1(a). 26 C.F.R.
15 § 301.7701-1(a). Thus, paragraphs 32 through 37 of the Amended Complaint allege
16 facts sufficient to establish treatment of the Operation as a partnership for federal
17 and California income tax purposes.

18 Although defendants do not dispute the existence of a partnership for
19 income tax purposes, defendants incorrectly state the income tax consequences of
20 this partnership. As demonstrated in more detail below, applicable income tax law
21 provides that, as a consequence of treatment of the Operation as a tax partnership:
22 (a) the income of such partnership is exempt from California personal income tax;
23 **(b) the character of the income of such partnership as so exempt "flows**
24 **through" to members of the Tribe in their capacities as partners;** (c) such tax-
25 exempt income increases tax basis of members of the Tribe in their interests in such
26 partnership; and (d) per capita distributions to members of the Tribe do not result in
27 any income or gain that is subject to personal income tax, because distributions by a
28

1 partnership result in no taxable income or gain to a partner (except to the extent such
2 distributions exceed the basis of the partner in the partnership).

3 a. Income of the Operation Is Exempt From Personal Income Tax

4 The Tribal Corporation enjoys the same exemption from personal
5 income taxes as the Tribe itself. See Revenue Ruling 81-295, 1981-2 CB 15
6 (holding that a federally chartered Indian tribal corporation shares the same tax
7 status as the Indian tribe and is not taxable on income from activities carried on
8 within the boundaries of the reservation). Incorporation does not constitute a waiver
9 of the sovereign immunity enjoyed by the Tribe:

10 Even though a tribal corporation is formed as a business
11 organization to engage in the conduct of corporate
12 business enterprises, **it is not separate and distinct** from
13 the tribe and so shares its immunity from federal income
14 taxes. That immunity extends to all business activities
15 carried on within the boundaries of the reservation.

16 General Counsel Memorandum 38853 (May 17, 1982) (emphasis added).

17 The Operation and each of its constituents, including the Tribe and the
18 Tribal Corporation, are persons authorized in accordance with IGRA to conduct the
19 Class III gaming operation on the reservation, including the Casino. (Amended
20 Complaint, ¶ 38.) The Operation, the Tribal Corporation and each such authorized
21 person are instrumentalities of the Tribe or treated as one for this purpose.

22 (Amended Complaint, ¶ 39.) The Tribe has not agreed to the imposition personal
23 income taxes on Class III gaming income from the Operation, the Tribal
24 Corporation or any such authorized person. (Amended Complaint, ¶ 40.)

25 In addition, Sections 2710(b)(3) and 2710(d)(1)(A)(ii) of IGRA limit
26 the purposes to which net revenues from Class III gaming revenues may be applied.
27 Those purposes include federal income tax but do not include any other taxes **other**
28 **than taxes to which a tribe has agreed pursuant to a compact with a State.** But

1 here, the State can point to no contract where the Tribe or its members have agreed
2 to be subject to personal income tax. Therefore, imposition of personal income tax
3 upon the members of the Tribe with respect to their distributive shares of income
4 from the Operation is preempted by federal law under the U.S. Constitution's Indian
5 Commerce Clause, Art. I, § 8, Clause 3.

6 The Operation shares the exemption from income taxes of the Tribe
7 and the Tribal Corporation with respect to Class III gaming income from the Casino.

8 b. Income of the Operation Remains Exempt from Personal Income
9 Tax When Allocated to Members of the Tribe

10 Pursuant to fundamental principles of partnership taxation, the
11 character of income from the Operation as exempt from income taxes flows through
12 to the members with respect to each member's share of such income, and such
13 income remains exempt from state income taxes in the hands of the members when
14 allocated to them and when received by them as per capita distributions pursuant to
15 the revenue allocation plan.

16 Internal Revenue Code Section 702(b) provides as follows:

17 The character of any item of income, gain, loss, deduction,
18 or credit included in a partner's distributive share under
19 paragraphs (1) through (7) of subsection (a) shall be
20 determined as if such item were realized directly from the
21 source from which realized by the partnership, or incurred
22 in the same manner as incurred by the partnership.

23 25 U.S.C. § 702(b).

24 A simple way to state the principle of Section 702) (b) is that tax-
25 exempt income of a partnership retains its character as tax exempt in the hands of
26 the members of the partnership. For example, interest income from tax-exempt
27 municipal bonds that are owned by a partnership is treated as tax-exempt in the
28 hands of the partners.

1 As a technical matter, this result is achieved as follows:
2 Paragraph (a)(7) of Section 702(a), referred to in Section 702(b) quoted above,
3 applies to "other items of income, gain, loss, deduction, or credit, to the extent
4 provided by regulations prescribed by the Secretary." 26 U.S.C. § 702. Under the
5 Treasury Regulations, § 1.702-1(a)(8)(i), these items include any item of income,
6 gain, loss, deduction, or credit subject to a special allocation under the partnership
7 agreement which differs from the allocation of partnership taxable income or loss
8 generally. 26 C.F.R. § 1.702-1. The amounts of income from the Operation
9 allocated to members of the Tribe are determined in accordance with special
10 allocations under the revenue allocation plan rather than based on income or loss of
11 the Operation generally. Thus, in accordance with Section 702(b), income from the
12 Operation allocated to members of the Tribe retains its character as exempt from
13 income taxes when so allocated to members of the Tribe.

14 The foregoing analysis follows the principles adopted by the Internal
15 Revenue Service in Revenue Procedure 72-18, § 4.05, dealing with the limitation on
16 deductibility of interest on indebtedness incurred by partnerships that
17 own tax-exempt state and local bonds. The revenue procedure holds that it is the
18 intent of the partnership (and not the intent of its individual partners) that is relevant
19 to determine whether the indebtedness was incurred to purchase or carry the tax-
20 exempt bonds (and thus determining whether the interest was or was not
21 deductible).

22 Allocations of income from the Operation to members of the Tribe also
23 are covered by paragraph (a)(7) of Section 702 (so that the character of such income
24 "flows through" to members of the Tribe) as a result of the application of Treasury
25 Regulations § 1.702-1(a)(8)(ii). This regulation provides that each partner must also
26 take into account separately the partner's distributive share of any partnership item
27 which, if separately taken into account by any partner, would result in an income tax
28

1 liability for that partner, or for any other person, different from that which would
2 result if that partner did not take the item into account separately.

3 In other words, if a person other than the Tribe, the Tribal Corporation,
4 or a member of the Tribe derives income as a partner in the Operation, that other
5 person would not be exempt from taxation on the income – IGRA, the Compact and
6 the revenue allocation plan do not extend so far as to preclude income taxation of
7 any other persons. The sovereignty of the Tribe and its exercise thereof, including
8 but not limited to determining the manner in which the Tribe provides for the
9 welfare of Members of the Tribe, does not extend to federal, state or local taxation
10 of persons who are not members of the Tribe.

11 c. Tax-Exempt Income from the Operation Allocated to A Member
12 of the Tribe Increases the Tax Basis of the Member in the
13 Operation

14 Each Tribal Member's share of income from the Operation increases
15 the tax basis of the Member's interest in the Operation. Section 705(a)(1) of the
16 Internal Revenue Code provides that the adjusted basis of a partner's interest in a
17 partnership shall be "(1) increased by the sum of his distributive share for the
18 taxable year and prior taxable years of: (a) taxable income of the partnership as
19 determined under section 703(a), (b) income of the partnership exempt from tax
20 under this title, and (c) the excess of the deductions for depletion over the basis of
21 the property subject to depletion." 26 U.S.C. § 705(a)(1).

22 Thus, both taxable and tax-exempt income of a partnership increase the
23 basis of a member of the partnership in his or her interest in the partnership.
24 Accordingly, income of the Operation allocated to members of the Tribe in
25 accordance with the Compact and the revenue allocation plan adopted pursuant
26 thereto increases the basis of a member in his or her interest in the Operation. This
27 enables distributions to be made to members of the Tribe without triggering taxable
28 gain, as explained immediately below.

1 d. Per Capita Distributions Pursuant to the Revenue Allocation Plan
2 Do Not Trigger personal income taxes

3 Section 731(a)(1) of the Internal Revenue Code provides as follows:

4 In the case of a distribution by a partnership to a
5 partner ... gain shall not be recognized to such partner,
6 except to the extent that any money distributed exceeds the
7 adjusted basis of such partner's interest in the partnership
8 immediately before the distribution.

9 26 U.S.C. § 731(a)(1).

10 As demonstrated above, income from the Operation allocated to a
11 member of the Tribe pursuant to the revenue allocation plan increases the tax basis
12 of that member in his or her interest in the Operation, even though the income is
13 exempt from personal income taxes. Pursuant to Section 731, distributions of cash
14 to the Members are applied to the basis of the member in such member's interest in
15 the Operation and so the distributions do not result in recognition of taxable gain.

16 2. Defendants' Arguments In Favor of Taxation Are Inapposite

17 In arguing for taxation, defendants make arguments that are inapposite
18 and misapprehend the allegations of the Amended Complaint and the applicable
19 rules of income taxation.

20 First, defendants argue that "partnership income is always taxed, only
21 the tax is imposed after the income is distributed to the partners." If this were true,
22 then interest on tax-exempt bonds held by a partnership would be taxable when
23 distributed to the partners. Such a result would be manifestly incorrect.

24 Second, defendants argue that per capita distributions to individual
25 Tribal members are expressly made subject to federal income tax, and
26 mischaracterizes the Amended Complaint as an argument that per capita
27 distributions are per se tax-exempt. The Tribe makes no such "argument." The
28 Amended Complaint alleges that imposition of personal income tax with respect to

1 allocations and distributions to members pursuant to the revenue allocation plan is
2 pre-empted pursuant to IGRA. As stated in paragraph 46 of the Amended
3 Complaint, "Per capita distributions are not taxable to the Members for purposes of
4 personal income taxes (i) because the increase in a Member's basis in the Operation
5 from allocation to the Member of income from the Operation offsets per capita
6 distributions from the Operation pursuant to the Revenue Allocation Plan,
7 (ii) pursuant to IGRA Section 2710(d)(4) or (iii) since imposition of personal
8 income taxes would interfere with sovereignty of the Tribe or its exercise thereof,
9 including but not limited to taxation of Members or the manner in which the Tribe
10 provides for the welfare of Members including housing." No allegation is made that
11 federal income taxation does not apply.

12 Finally, defendants argue that the allegations of the Complaint would
13 require an exemption from personal income tax for persons other than members of
14 the Tribe. As indicated previously, pre-emption of personal income tax is premised
15 on the application of IGRA and the revenue allocation plan to the particular
16 Operation of the Casino and exercise of sovereignty by the Tribe in providing for
17 the welfare of its members. The exemption from personal income taxes does not
18 extend to other persons.

19 This principle is well-illustrated by the case of Craik v. United States,
20 31 F. Supp. 132 (Ct. Cl. 1940). The court held that a nonresident alien individual
21 partner of a partnership operating in the United States was not subject to United
22 States federal income taxation on his distributive share of the partnership's foreign-
23 source income, since the foreign-source character of the income flowed through
24 from the partnership to the nonresident alien individual partner and nonresident
25 alien individuals were not taxable on foreign-source income of the type earned by
26 the partnership. Nonetheless, the character of the income as exempt in the hands of
27 the nonresident alien individual partner would not extend so far as to exempt from
28 United States federal income taxation the distributive share of a United States

1 citizen or resident member of the partnership. Likewise, the exemption from
2 personal income taxes of income of the Operation extends to the members of the
3 Tribe whose welfare is the concern of IGRA, the Compact and the revenue
4 allocation plan adopted pursuant thereto, but would not extend to other persons.
5 Defendants' argument in this regard is entirely inapposite.

6 F. The Tax Injunction Act Does Not Bar the Third Claim for Relief

7 In general, the Tax Injunction Act, 28 U.S.C. § 1341 prohibits federal
8 courts from enjoining the collection of any state tax where the plaintiff has a plain,
9 speedy and efficient remedy may be had in state court. The Tax Injunction Act does
10 not apply for two reasons. First, the Act does not apply to lawsuits brought by
11 Indian tribes under federal law. Moe, et al. v. Confederated Salish and Kootenai
12 Tribes of the Flathead Reservation, et al., 425 U.S. 463, 96 S. Ct. 1634, 1644, 1645,
13 48 L. Ed. 2d 96 (1976). District courts have original jurisdiction of all civil actions
14 brought by any Indian tribe wherein the matter in controversy arises under the
15 Constitution, laws, or treaties of the United States. 28 U.S.C. § 1362. The purpose
16 of § 1362 was to "open the federal courts to the kind of claims that could have been
17 brought by the United States as trustee [for the Indians], but for whatever reason
18 were not so brought." Moe, 425 U.S. at 473. Because the United States is not
19 barred by § 1341 from seeking to enjoin the enforcement of a state tax law, an
20 Indian tribe is not barred from doing so. Moe, 425 U.S. at 475; see also Chippewa
21 Trading Co. v. Cox, 365 F.3d 538, 544 (6th Cir. 2004) (Tax Injunction Act applies to
22 individual Indian, not tribe).

23 In addition, the Tax Injunction Act does not apply because the Tribe
24 has no "plain, speedy and efficient remedy" in state court. California provides
25 taxpayers with administrative and judicial remedies for challenging assessments.
26 Capitol Industries, supra, 681 F.2d at 1113. The Tribe is not a taxpayer. Because
27 no such relief is available for non-taxpayers, the Act does not apply. Id. at 1118 -
28

