OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **R. GARCIA AND** **M. GARCIA**	OTA Case No. 20076335

OPINION ON SEVERED ISSUES

Representing the Parties:

For Appellants:	Lester J. Marston, Attorney Lydia Turanchik, Attorney
For Franchise Tax Board:	Maria Brosterhous, Tax Counsel IV Topher Tuttle, Tax Counsel III
For Office of Tax Appeals (OTA):	Grant S. Thompson, Tax Counsel IV

J. JOHNSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, appellants R. Garcia and M. Garcia appeal actions by respondent Franchise Tax Board proposing additional tax of $223,772, $191,070, and $198,292 for, respectively, the 2010, 2011 and 2012 tax years.

OTA Administrative Law Judges John O. Johnson, Sheriene Anne Ridenour, and Tommy Leung held an oral hearing for only the jurisdictional issues in this matter on August 25, 2021.[1] At the conclusion of the hearing, the record was closed with respect to this Opinion on the severed issues.

ISSUES

Whether OTA has jurisdiction to consider appellants' arguments regarding:

(1) Constitutional issues;

(2) Federal preemption;

(3) The "*Colville* apportionment" issue; and

[1] The parties agreed to hold the hearing electronically via Webex.

(4) Underground regulation or Administrative Procedures Act (APA) issues.

FACTUAL FINDINGS

1. Appellant-husband is an enrolled member of the San Manuel Band of Mission Indians (Tribe), a federally recognized Indian tribe. During the years at issue, the Tribe made per capita payments of gaming income to its members, including appellant-husband.
2. During the years at issue, appellant-husband owned a home located on the Tribe's reservation and also maintained homes outside the reservation in the State of California.[2] Appellants also owned residential property in New York City, New York during the years at issue.
3. Appellants filed California resident income tax returns for the tax years at issue. On the tax returns, appellants deducted per capita gaming income from their California income.
4. Respondent examined appellants' tax returns and determined that appellants improperly deducted per capita gaming income from their California income. Respondent issued Notices of Proposed Assessments (NPAs) reflecting its determination.
5. Following protest proceedings, respondent issued Notices of Action (NOAs) affirming the NPAs. Appellants filed this timely appeal from the NOAs.
6. On appeal, appellant-husband provides a declaration stating that, during the tax years at issue, he "lived both on and off the Reservation" but that his principal residence was located on the reservation. He also states that he "resided on the Reservation and in the State of New York" during the tax years at issue, that he owned two homes outside of the reservation and that, from 2010 to 2012, he attended school and "lived in" New York City.[3]

[2] In appellants' presentation at the oral hearing, it was stated that they maintained homes outside the reservation in the State of California in San Juan Capistrano and in Long Beach. Respondent indicated in briefing that appellants may also own or have ownership interests in properties in Huntington Beach, California, and Newport Beach, California. The parties may clarify property ownership details in briefing subsequent to this Opinion on the severed jurisdictional issues.

[3] During the first prehearing conference, appellants' representative confirmed that appellant-husband was a resident of California during the years at issue, and therefore the issue of residency is not an issue to be determined on appeal in either this Opinion or the opinion to follow.

DISCUSSION

The primary code section at issue here is R&TC section 17041(a), which imposes California income tax on the "entire taxable income of every resident of this state who is not a part-year resident . . . ." A California resident includes "[e]very individual who is in this state for other than a temporary or transitory purpose" and "[e]very individual domiciled in this state who is outside the state for a temporary or transitory purpose." (R&TC, § 17014(a).) Case law in effect for the years at issue states that California may tax all of the taxable income, including reservation-source income, of a tribal member that resides outside of his or her tribe's reservation. (*Mike v. Franchise Tax Bd.* (2010) 182 Cal.App.4th 817 (*Mike*); *Appeal of Arviso* (82-SBE-108) 1982 WL 11785.)[4] As discussed in these cases, the analysis of whether per capita gaming revenue received from a taxpayer's tribe is taxable by the state has focused on whether or not the taxpayer resided on his or her tribe's reservation. Respondent's briefing to this point has focused on this analysis.

Appellants' briefing has alternatively focused on whether California has the authority to tax per capita gaming revenue that appellant-husband, who is a California resident, received from his Tribe, regardless of whether appellant-husband resided on his Tribe's reservation.[5] Appellants' contentions fall into four categories, identified as the severed issues on appeal here, and are discussed below.

1. Constitutional Issues

Appellants present arguments, in addition to federal preemption (discussed below), asserting that respondent's proposed assessment of tax based on appellant-husband's per capita gaming revenue is unconstitutional, including that the imposition of state tax is invalid because it fails to apportion the income and that it violates the Indian Commerce Clause.

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[4] Effective for taxable years beginning on or after January 1, 2018, R&TC section 17131.7 codifies and expands this exemption by removing the requirement that the taxpayer reside on his or her own tribe's reservation by instead requiring that the taxpayer reside within any Indian country (e.g., reservation, etc.) in California. This code section also removed a requirement that the income at issue be derived from the taxpayer's tribe's reservation sources, and instead requires that the income at issue be derived from sources within any Indian country in California.

[5] Appellants also maintain that appellant-husband's principal residence for the years at issue was his home on the Tribe's reservation and therefore they qualify under the analysis used by respondent. However, the issue of whether appellants resided on the reservation or not is reserved for the remainder of the appeal that will follow this Opinion on the severed issues of jurisdiction.

Article III, section 3.5, of the California Constitution provides as follows:

> An administrative agency . . . has no power:
>
> (a) To declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional;
>
> (b) To declare a statute unconstitutional;
>
> (c) To declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.

Also, California Code of Regulations, title 18, section 30104(a) provides that OTA does not have jurisdiction to determine "[w]hether a California statute is invalid or unenforceable under the United States or California Constitutions, unless a federal or California appellate court has already made such a determination." In addition, our predecessor, the Board of Equalization (BOE), had a long-established policy of abstaining from deciding constitutional issues, at least in appeals from proposed assessments.[6] (See, e.g., *Appeal of Aimor Corp*. (83-SBE-221) 1983 WL 15592.)

In *Mike*, the California Court of Appeal considered the application of *McClanahan v. Arizona State Tax Commission* (1973) 411 U.S. 164 (*McClanahan*) and *Washington v. Confederated Tribes of the Colville Reservation* (1980) 447 U.S. 134 (*Colville*),[7] as well as other relevant authorities, to California's income tax. It determined that respondent could tax the per capita gaming income of a tribal member who did not reside on her tribe's reservation. The court stated that "[i]t is clear that an Indian may not move away from the lands reserved for the exclusive use of the tribe in which he or she is enrolled and into the general population while

[6] This policy was established prior to the addition of section 3.5 to article III of the California Constitution. (See *Appeal of Henderson* (80-SBE-017) 1980 WL 4945, citing BOE decisions preceding the addition, in 1978, of section 3.5 to Article III of the California Constitution.)

[7] *McClanahan* evaluated the United States Government's treaty with the Navajo Nation, the Buck Act (4 U.S.C. § 104, et seq.) and Arizona statutes, and concluded that Arizona could not impose an income tax on a tribal member, living on her reservation, who earned income solely from reservation sources. In *Colville*, the Court held that the State of Washington could impose cigarette and sales taxes on purchases made on the reservation by individuals who were not members of the governing tribe and also held that the taxation of vehicles used both on and off the reservation needed to be somehow tailored to tax the amount of off-reservation use.

nevertheless retaining the tax exemption for income afforded to that Indian under *McClanahan*." (*Mike*, *supra*, 182 Cal.App.4th at p. 829 [citations omitted].)

Mike, the most relevant appellate-level case law on point, does not support a finding that the application of R&TC section 17041 as applied in respondent's proposed assessment is unconstitutional, but rather supports respondent's application of R&TC section 17041 here when it comes to constitutional questions. Accordingly, we have no jurisdiction to find that the proposed assessment is invalid based on appellants' constitutional arguments.

2. Federal Preemption

Appellants argue that the Indian Gaming Regulatory Act, 25 U.S.C. section 2701, et seq. (IGRA), and regulations and authorities established pursuant to IGRA, preempt California's authority to tax appellant-husband's per capita gaming income. As noted above, Article III, section 3.5, of the California Constitution prohibits us from ruling that IGRA or federal regulations prohibit the enforcement of R&TC section 17041, unless an appellate court has already determined that preemption bars enforcement of "such statute." No appellate court has made such a determination with respect to R&TC section 17041 or any other California income tax statute. Accordingly, we are constitutionally prohibited from ruling on that basis.

The only appellate court decision that addresses the imposition of California income tax on per capita income is *Mike*. In *Mike*, the court affirmed that respondent could tax the per capita income of a tribal member who did not reside on her tribe's reservation. As appellants acknowledge, the court did not address whether IGRA preempted application of the California income tax on per capita income. Thus, *Mike* provides no assistance to appellants' argument that IGRA preempts the application of California income tax statutes.

Appellants contend that *Sharp Image Gaming, Inc. v. Shingle Springs Band of Miwok Indians* (2017) 15 Cal.App.5th 391 (*Sharp Image*) supports their preemption argument. Appellants point to the court's statement that Congress intended for IGRA to "completely preempt state law." (See *Sharp Image*, *supra*, 15 Cal. App.5th at p. 421, quoting *Gaming Corp. of America v. Dorsey & Whitney* (8th Cir. 1996) 88 F.3d 536, 544.)

Sharp Image found that IGRA preempted the application of state contract law to certain contracts. Specifically, *Sharp Image* only held that IGRA preempts the application of state law to certain agreements which IGRA requires to be approved by the National Indian Gaming Commission. (See *Sharp Image*, *supra*, 15 Cal.App.5th at pp. 406-407.)

Sharp Image did not rule that IGRA preempted the application of R&TC section 17041 or any other California tax statute. It did not rule upon, or cite, any California tax statute. Also, it did not address *Mike*, which is the only California appellate court decision that has addressed the taxation of per capita gaming income. This suggests that the court did not view *Mike* as relevant precedent for the issue before it.

Article III, section 3.5, of the California Constitution, requires an appellate court ruling that the enforcement of "such statute" is preempted by federal law. As *Sharp Image* did not rule that the enforcement of R&TC section 17041 or any other California income tax statute is preempted by IGRA, it does not provide a basis for us to so rule.[8] While appellants argue that the Administrative Law Judges of OTA have a responsibility to ignore state laws that are in conflict with federal law, the California Constitution and relevant case law is clear that we do not have such authority. (*Capitol Industries-EMI, Inc. v. Bennett* (9th Cir. 1982) 681 F.2d 1107, 1117.) The rightful process for appellants to seek such remedy is to pay the proposed assessment, request a refund, and pursue their constitutional arguments in the courts. (See *Hyatt v. Yee* (9th Cir. 2017) 871 F.3d 1067, 1074.) Accordingly, we have no jurisdiction to find that the proposed assessment is invalid based on appellants' federal preemption arguments.

3. The *Colville* Apportionment Issue

Appellants raise an alternative argument that, because appellant-husband lived and received income both on and off the reservation and California did not apportion its tax between his on-reservation and off-reservation income, California is prohibited from taxing *any* of his per capita gaming income. In support, appellants cite *McClanahan* and *Colville*.

McClanahan and *Colville* address federal constitutional and preemption issues. *McClanahan* provides the inception of the prohibition of state taxation of tribal income when specific factors are met. Appellants cite to *Colville*, upon which appellants primarily base their arguments for apportionment, wherein it states that a Washington state tax on vehicles used both on and off a reservation should be "tailored . . . to the amount of actual off-reservation use, or otherwise varied" to acknowledge on-reservation use. (*Colville*, at p. 163.) Appellants assert this portion of *Colville* creates a requirement for state tax laws to apportion taxes to reflect on-

[8] In effect, appellants argue that the logic of *Sharp Image* should be extended to find that IGRA also preempts the application of California's income tax statutes. However, as no appellate court has so ruled, Article III, section 3.5, of the California Constitution and California Code of Regulations, title 18, section 30104(a) prohibit us from ruling on this basis.

reservation and off-reservation activities, and applies that theory to per capita income received by a tribal member residing both on and off the reservation. Appellants argue that respondent did not tailor its income tax to reflect appellant-husband's facts of residing both on and off the reservation, and therefore the imposition of the tax is prohibited in its entirety.

In response to appellants' argument that respondent's proposed assessment is unconstitutional because it is not apportioned, respondent indicates that it reviewed appellants' financial transactions and determined that more than 90 percent of the transactions occurred within 30 miles of appellants' San Juan Capistrano property. Respondent asserts that OTA has jurisdiction to review whether, under *Colville*, respondent has improperly apportioned appellant-husband's per capita gaming income based on where he lived during the years at issue.

As noted above, under Article III, section 3.5, of the California Constitution, we cannot declare a California statute unconstitutional or preempted, or refuse to enforce it on that basis, unless an appellate court has determined that "such statute" is unconstitutional or preempted. As neither *McClanahan* nor *Colville* declared that California's income tax statutes are unconstitutional or preempted, we cannot apply those cases to declare that California's income tax statutes should not be enforced or to refuse to enforce them as written (aside from the limited exception of a tribal member receiving tribal income while residing on the tribe's reservation).

We find nothing contained within *Colville* that authorizes an application of R&TC section 17041 that involves apportioning per capita gaming income between taxable and nontaxable based on a percentage of transactions a taxpayer engaged in off versus on his or her reservation during the tax year. Instead, the law as properly applied does account for on-reservation and off-reservation activity by only taxing per capita gaming income received by a tribal member from his or her tribe when that individual is residing off-reservation. The language of the statue and case law, including *Mike*, states that reservation-sourced income received by a tribal member shall be exempted from taxation only when it is received while the taxpayer is residing on the tribe's reservation.[9] This application of the California income tax law is not in conflict with *Colville*.

[9] Outside of this limited exception allowing for tribal-sourced income of a California resident who is a member of a tribe to be treated as nontaxable, the applicable law, i.e., R&TC section 17041(a), provides that California income tax is imposed on the "entire taxable income of every resident of this state who is not a part-year resident . . . ," without any apportionment provisions based on where in the state transactions occurred.

Accordingly, we find that OTA does not have jurisdiction to apportion reservation-sourced income as contended by appellants or as proposed by respondent, pursuant to *Colville*.[10]

4. Underground regulation or APA issues

In response to respondent's proposed apportioning of the income at issue, appellants do not agree with respondent's proration method, and instead, appellants contend that respondent's proposed apportionment methodology is unenforceable because it constitutes an underground regulation. As we find no jurisdiction for OTA to apportion the income at issue under the facts and arguments as presented, the contentions regarding an underground regulation are moot and no longer at issue in this appeal.

[10] We note that if respondent were to partially concede the amount at issue by voluntarily reducing its proposed liability, OTA would then only address the revised amount at issue and not the conceded amount, but OTA does not have jurisdiction to direct respondent to reduce its proposed liability here based on an apportionment theory as presented by the parties.

HOLDING

OTA has no jurisdiction over appellants' arguments regarding constitutional issues, federal preemption, the "*Colville* apportionment" issue, or underground regulation or APA issues.[11] Accordingly, the appeal will continue with the only remaining issue being whether respondent properly determined that per capita gaming income received by appellant-husband from his Tribe during the years at issue is subject to California taxation, and specifically the question of whether appellant-husband resided on his Tribe's reservation during the years at issue.

DISPOSITION

OTA has no jurisdiction to consider the contentions addressed in this Opinion on the severed issues, and the appeal shall proceed to further briefing on the last remaining issue as detailed in the Holding above.

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John O Johnson
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John O. Johnson
Administrative Law Judge

We concur:

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Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
Tommy Leung
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Tommy Leung
Administrative Law Judge

Date Issued: 12/6/2021

[11] This finding of a lack of jurisdiction over these issues extends to include any additional sub-theories or permutations of these arguments. To the extent that appellants have raised any such arguments that we have not specifically addressed, we have considered them and found them to be outside of the scope of our jurisdiction for this appeal. This appeal will resume with only the issue specified in this Holding as the remaining issue on appeal.