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Tribal Hotel Occupancy Taxes

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A. How Hotel Occupancy Taxes Work

1. What is a "HOT?"

Hotel Occupancy Taxes (HOT) are now a familiar part of the travel landscape in the United States. Typically, these taxes are authorized by a state legislature to be imposed by a county or municipality under certain conditions.[1] The actual incidence of the tax, that is, upon whom it is imposed, varies from jurisdiction to jurisdiction. The two most common forms of imposition are on the lodger, and on the hotel supplying the lodging.[2] The taxes are universally measured as a percentage of the room cost, and those percentages range from 2% to total impositions in some cities exceeding 16% of the price of the room.

2. What the HOT is useful for

Most jurisdictions, including tribal jurisdictions, have made use of the HOT because its incidence falls on travelers, not local taxpayers. In addition, unlike local add-on sales taxes, which often can create a disincentive to shoppers, HOT taxes are almost universal, thereby eliminating any worries that the imposition will create a competitive disadvantage to local hotels. Local governments that adopt a HOT designating all or a significant portion of the revenues for promoting tourism or economic development find support for the tax with the local business community, and rely on the tax as a means to fund local "tourism-based" activities.

3. HOT is easy to set up and administer

The system for administering a HOT tax is relatively simple, and does not require complex audit or appeal procedures, unlike income taxes, business activity taxes, or the

[1] The most typical condition is that the funds collected be utilized for the promotion of tourism in the locality.

[2] For example, Texas, West Virginia and Tennessee impose the tax upon the lodger, with a corresponding duty on the hotel to collect and report. Pennsylvania and Illinois impose the tax on the hotel, but allow the hotel to pass on the tax without increasing the hotels' gross receipts. Many jurisdictions also impose sales tax on the same transaction. In New York City for example, a lodger pays an occupancy tax and a city sales tax and a state sales tax on the same transaction.

like. For a tribe just starting a tax program, this tax can be managed out of the typical Tribal Finance Office without the need to develop significant new staffing or procedures. For a tribe with an established tax program, the addition of a HOT should pose few logistical problems. A sample Reporting Form 700 from the Navajo Tax Commission is included in the materials. This form is used by the hotel to report its gross receipts from room rentals[3], minus exempted rentals.[4]

4. Recommended incidence for the HOT

In conducting my survey of non-tribal jurisdictions imposing the tax, I was surprised by the lack of precision in most state HOT statutes. This problem was most evident in the area of "incidence"-- the definition of whom the tax would fall on. Similarly, a high proportion of state and local tax statutes analyzed did not make accurate or precise provisions for pass-through of the tax to the lodger, but virtually all jurisdictions actually administer the tax to obtain this result.

In Indian Country, where every tax is subject to the scrutiny of the federal courts, it is advisable to look very carefully at the party upon whom the incidence of the tax will rest. In the next sections I will discuss this issue in detail.

B. Litigation History

1. The Navajo HOT

i. Enacting the Tax

In 1991, the Navajo Nation Department of Justice drafted the original Navajo Nation Hotel Occupancy Tax to tap the large volume of tourist activity drawn to the Navajo Nation, and to bring in needed revenue to fund tourism promotion and economic development activity. The Navajo Tax Commission was then already a mature institution, and had extensive experience administering the Nation's business activity tax (BAT) and its possessory interest tax (PIT). The Commission had the staff and experience to administer the HOT with few changes.

The lodging base of the Nation consisted of tribally-owned facilities, privately held facilities on tribal leased land, and some facilities on fee land entirely within the boundaries of the Reservation. Preliminary analysis of the jurisdictional landscape led the drafters to suggest that the incidence of the tax should fall on the guests of each hotel, since without exception guests would have traveled many miles through Navajo Nation lands to reach their accommodations, and would necessarily have made a choice to enter the Reservation in doing so.

[3] Incidental sales to the room, such as room service, movies, etc., are not included in a HOT.
[4] Some jurisdictions exempt federal travelers, others state officials, and at the Navajo Nation, government employees who fill out an exemption form.

The Nation adopted the HOT in 1992. The statute was based on the state of Texas model, which places the incidence of the tax on the lodger, but obligates the hotel to collect the tax on behalf of the state.[5] In addition, like the Texas statute, the Navajo statute offered the hotel operator a 1% rebate as compensation for filling out the forms, and reporting and paying the taxes to the Nation.

ii. Designating a tourist fund for proceeds

The Navajo statute also expressly limited the use of HOT revenues to the purposes of promoting tourism and tourism development within the Nation.[6] It was believed at the time that the threefold incentive of imposing the tax on the tourist and not the hotel, offering the hotel the rebate for collection, and the dedication to the tourism fund would encourage compliance from operators who might otherwise have challenged the tax.

The tax was immediately successful. Although some operators were initially concerned about the perceived competitive disadvantage due to the 8% tax, in reality there was no measurable impact from the tax on visitor nights spent within the Nation. In the early years of the HOT, it generated more than a million dollars a year for the Nation.

2. *Atkinson Trading Co. v. Shirley*

Despite the best intentions of the Nation, one hotel, Atkinson's Trading Post, operating north of Flagstaff, Arizona on State Route 89, which runs through the Navajo Nation on its way to Grand Canyon National Park, refused to collect the tax and refused to submit to a Navajo Nation audit. Litigation commenced in the Navajo Nation court system, progressed to the Navajo Nation Supreme Court, which ruled in favor of the Tax Commission, and then proceeded through the federal system.[7] The tax was upheld in both the United States District Court and the 10th Circuit Court of Appeals.

Then it proceeded to the United States Supreme Court where, unfortunately for the Navajo Nation and Indian Country, the case was used as the definitive statement on tribal regulatory and taxing authority over non-members on fee land. Because this article concerns the HOT, my analysis of *Atkinson* will look in particular at how the case determined jurisdictional issues related to the Navajo HOT, how the Supreme Court looked at the incidence question, and what those answers mean for tribes considering a HOT today.

i. The *Strate* lineage

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[5] *See*, Texas Tax Code, Chapter 156. Hotel Occupancy Tax (as amended 1995)

[6] While sequestering HOT revenue for tourism promotion is common to many jurisdictions, nothing other than legislative policy guides the decision to do so. Texas, for example, amended its HOT in 1995 to direct HOT funds into the state general fund.

[7] *Atkinson Trading Co. v. Shirley*, 532 U.S. 645 (2001) (Included in materials).

Atkinson was decided based on the "bright line" reading of *Montana* in *Strate v. A-1 Contractors*, 520 U.S. 438 (1997). The decision focused on the fee status of the trading post, and utterly rejected the Nation's argument that the area was overwhelmingly Navajo in character, that Atkinson's relied almost exclusively on Navajo employees, the work of Navajo artisans, and the fire and emergency services provided to it by the Nation. The Supreme Court focused its jurisdictional analysis on the ownership status of the site of the trading post, even while acknowledging that the trading post itself was not statutorily subject to the Navajo tax, but rather to the duty to collect and remit the tax.

Finding that the Nation had no basis to assert taxing jurisdiction over Atkinson Trading Post, because of its fee status and non-member ownership, the Court then dismissed the Nation's imposition of the HOT on Atkinson's customers by utilizing *Strate's* "functional equivalent of fee land" rule for state highway rights of way: even though Atkinson's customers had entered the Nation and driven miles through the Nation, those customers could have done so by driving Highway 89, and thus never come within the Nation's jurisdiction.[8] If there was never a jurisdictional nexus between the Nation and Atkinson or its customers, the Nation had no authority to levy the HOT. Case closed.

ii. *Montana* still rules

Atkinson's modern exposition of *Montana* teaches us that there is only one certain source of tribal taxing authority over non-member activities on fee land within the Reservation.[9] If a Tribe wishes to impose a tax in those circumstances, it must be with the consent of the taxed, and must be memorialized in a "contract, lease(s) or other arrangement." *Atkinson*, at 9*, quoting Montana*. *Atkinson* also tells us that the contract or other document must contemplate the tax imposed. A contract which fails to document the agreement to pay the tax will lack the requisite nexus the Supreme Court found lacking in *Strate.*

The Supreme Court blithely assumes that such a "consensual document" is possible to obtain. But who would willingly consent in writing to the imposition of a tax that would not otherwise apply? For Tribes with significant natural resources, or significant property or business bases that are attractive to outside developers, such arrangements might yet be possible. An agreement by the non-member to pay tax on property or activities on fee land might be part of an overall business package negotiated with a

[8] It did not concern the Court that a lodger at the Trading Post could as easily spent the day at Tuba City, or anywhere else within the Nation, and have simply turned up Route 89 for the final few miles of their trip.
[9] *Montana* limits tribal civil regulatory authority over non-members' activities on fee land. *Strate* extends the definition of fee land to include rights of way over which a Tribe has surrendered the power to exclude. *Atkinson* brings tribal taxing authority to the table, and for the first time establishes a presumption that tribes have no taxing authority over non-members on fee lands, including rights-of-way. While the Court has never modified the words of either the first or second exception to Montana's general proposition that tribes have no regulatory authority over non-member activities on fee land, for all practical purposes there are almost no circumstances where the Court would determine that a non-member's activities on fee land so imperiled the Tribe as to justify the extension of tribal authority to the land or the non-member. By the same token, the Court has continued to whittle away at the meaning of "consensual relations" until that term is virtually synonymous with "written contract concerning the jurisdictional assertion of the Tribe."

Tribe. In the context of a HOT, however, such scenarios are very limited. For all practical purposes, a tribal tax program which depends on taxing the property, use or activities of non-members on fee land is a dead letter after *Atkinson*.[10]

3. The aftermath for the Navajo Nation

i. A thriving hotel tax program

Atkinson caused the Navajo Nation to lose approximately $70,000 per annum, but the Navajo Nation Tax Program retains its strength and vitality post-*Atkinson*.[11] The HOT continues to generate annual revenues in the million-dollar range. Because the Navajo Nation has such a huge trust land base, and because the majority of hotels located within the Nation are located on these trust lands, *Atkinson* does not pertain.

ii. A huge opportunity in the advent of gaming

For the Navajo Nation, which has yet to build its first casino, the future of the HOT is bright. News releases suggest that the Nation plans to build at least three casino/hotel facilities, all on tribal trust land, and all near major interstate routes. The HOT should generate substantially increased revenue into the future.

C. Competing State Hotel Taxes

For tribes contemplating the development of a hotel/casino complex, it is important to understand the potential impact of state taxation on such an enterprise, including whether state HOT taxes may be imposed on lodging created or sponsored by the tribe.

1. *Yavapai-Prescott Indian Tribe v. Scott*

In 1997, the Ninth Circuit Court of Appeals decided a case that shocked Indian Country analysts. In *Yavapai-Prescott Indian Tribe v. Scott*, 117 F.3d 1107 (9th Cir. 1997), the Ninth Circuit Court of Appeals upheld Arizona's imposition of business activity, use and occupancy taxes on the operator of a hotel 1) that was located on leased tribal trust land, 2) that was partially financed by the Yavapai Tribe, 3) which the Tribe had an interest in up to 20% of the hotel's net income, and 4) that was connected to a casino owned, operated and controlled by the Tribe.

The Court correctly concluded that federal law required a balancing test of state and tribal interests to determine whether the state tax on the non-Indian hotel patrons was preempted by federal law.[12] However, the balancing factors utilized by the court were

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[10] As an additional note, any tribe that leases fee lands it holds within its own reservation would be wise to negotiate a tax clause in the lease document.

[11] The Navajo Nation's Tax Commission provides online recaps of all taxes and revenues at its site, www.**navajotax**.org . The most recent revenue figures are included in the materials.

[12] This result is obtained because in Indian law, the incidence of a state tax is everything: if it falls directly on the Tribe, it is presumed preempted by federal law. *See, e.g., White Mountain Apache Tribe v. Bracker*, 448 US 136 (1980). In *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 459 (1995) the Court

skewed dramatically in the State's favor, as pointed out by Judge Pregerson in the dissenting opinion. The factors that led the court to decide against the Yavapai Tribe were and remain important factors for any tribal enterprise to consider:

> "1. There is no evidence of employment by the Hotel of any members of the Tribe. The district court said that the record was not clear on this point. It was the Tribe's burden to provide evidence of tribal employment if there was any. PCC had agreed to prefer tribal members in hiring. The Hotel employs between 150 and 200 persons. The manager of the Hotel was not aware of any employee from the Tribe.
> 2. The bulk of the funding for the Hotel came from non-tribal and non-federal sources.
> 3. The tribal contribution to the quality of the food served at the Hotel is minimal -- an inspection two or three times a year.
> 4. The Tribe receives only a guaranteed 1-1/4 percent of the Hotel's gross revenues. The record does not reveal what it has received in terms of the 20 percent of net revenues. As the Tribe's expert Joseph Kalt stated, this return is "subject to capital recapture provisions."
> 5. The Tribe does not have an active role in the business of the Hotel.
> 6. The State provides these services to the Hotel:
> (a) The criminal law governing the operation of the Hotel, such as the statutes on fraud, on checks and credit cards, and on embezzlement. See, e.g., A.R.S. S 2310 (fraudulent schemes and artifices).
> (b) The law governing liens, Red Mountain Machinery Co. v. Grace Investment Co., 29 F.3d 1408, (9th Cir.), cert. denied, 115 S. Ct. 639 (1994), and other security instruments such as the mortgages by which the Hotel is financed.
> (c) The law governing employment at the Hotel, including the workman's compensation law specifically referenced by the lease."

Yavapai-Prescott Indian Tribe v. Scott , 117 f.3d 1107, ____(9th Cir. 1997).

Balanced against these factors were the following factors favoring preemption of the State taxes:

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set out the state of the law: "But when a State attempts to levy a tax directly on an Indian tribe or its members inside Indian country, rather than on non-Indians, we have employed, instead of a balancing inquiry, "a more categorical approach: '[A]bsent cession of jurisdiction or other federal statutes permitting it,' we have held, a State is without power to tax reservation lands and reservation Indians." *County of Yakima* v. *Confederated Tribes and Bands of Yakima Nation,* 502 U. S. 251, 258 (1992) (citation omitted). Taking this categorical approach, we have held unenforceable a number of state taxes whose legal incidence rested on a tribe or on tribal members inside Indian country. See, *e. g., Bryan* v. *Itasca County,* 426 U. S. 373 (1976) (tax on Indian-owned personal property situated in Indian country); *McClanahan,* 411 U. S., at 165–166 (tax on income earned on reservation by tribal members residing on reservation)."

> "1. The fee is held by the United States in trust for the Tribe.
> 2. The Tribe has furnished the site for the Hotel.
> 3. The Tribe has ownership of the Hotel, its facilities, and all improvements.
> 4. The Tribe has a residual interest in the assignment of the lease.
> 5. The Tribe, with the help of the federal government, furnished approximately 11 percent of the construction cost of the Hotel.
> 6. Since 1992 the Tribe has operated on the premises of the Hotel slot machines and automated poker games which attract some patrons to the Hotel.
> 7. The income from the lease contributes to the economic well-being and self-sufficiency of the Tribe.
> 8. The Secretary of the Interior has approved the leases involved."

Id. at __.

Although the Tribe had entirely created this economic opportunity by building the hotel casino complex on its own land, because it had surrendered management and control of the hotel, the Court ruled against the Tribe and in favor of state taxation.

The opinion is shocking in its obdurate refusal to consider the reality of the situation: the Tribe itself owned and operated the gaming enterprise located side by side with the hotel, which it also owned. The gaming, as Judge Pregerson noted in the dissent, added substantial reservation value to the hotel enterprise. Yet the majority ignored this vital fact, and proceeded to perform a clumsy *Colville* "reservation value analysis"[13] without once truly considering the magnitude of what the Yavapai-Prescott Tribe had accomplished, or that none of the value the Court thought the State should have the right to tax would have existed, but for the Tribe. The Supreme Court denied certiorari in this instance,[14] so in the Ninth Circuit the decision stands.

It is important to understand that the state preemption analysis differs sharply from the *Montana* analysis used to preclude tribal taxation in *Atkinson*. These same *Yavapai* facts would not defeat a tribe's own HOT or other taxes. However, any time an enterprise is asked to carry the taxing burden of multiple jurisdictions, at the least, the competitive edge of the owner is reduced, and at the most, the enterprise is so burdened by taxation that it cannot effectively compete in the market. Since the *Yavapai* decision, several other tribes have successfully fended off efforts at state taxation based upon their

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[13] *Washington v. Conf'd Tribes of Colville Indian Reservation*, 447 U.S. 134, 155 (1980). While the *Yavapai* Court makes no special reference to *Colville*, it is clear the Court is contemplating "reservation value added" when it weighs the absence of tribal employees at the restaurant and hotel. Obviously, if tribal member employees are preparing the food, reservation value is added. Similarly, if tribal member employees are making up hotel rooms, providing service to those rooms, etc., an aspect of reservation value is added. Unfortunately, the Yavapai case fails to discuss its rationale in these matters.

[14] *Yavapai-Prescott Indian Tribe v. Scott*, Docket No. 97-796. Petition for Certiorari denied January 20, 1998.

ownership and operation of the facility in question, and the nature and incidence of the tax collected.[15]

2. Conclusions based on *Yavapai*

The lesson to be learned from the *Yavapai* case is that mere ownership of the land beneath a business in Indian country is insufficient to avoid state taxes where the incidence of the tax does not fall on the Tribe. Wherever possible, Tribes should own, operate and regulate every guest facility operated on its land or associated with its gaming enterprise, and should strive to place at least some tribal employees in that enterprise.[16]

In the state of Washington, the retail sales tax is imposed on all hotel room rentals. RCW 67.28.180. When a county or municipality adopts a transient occupancy tax under RCW 67.28.190, that tax is deducted from the 6.5% state sales tax. The incidence of both taxes is on the lodger. Therefore, in Washington, such taxes would not be presumptively invalid, but would be subject to the balancing test set out in *White Mountain Apache Tribe v. Bracker,* 448 U.S. 136 (1980), and further "developed" in the *Yavapai* case.[17]

D. Low Risk Recommendations For Enacting a Tribal HOT

1. Impose the tax consistent with *Atkinson*

i. Know your relationship to the taxed

The Tribal jurisdiction must insure that it has an adequate basis under the *Montana* test to assert taxing jurisdiction over the party. If the Tribe intends to impose a HOT only on patrons at its own sites located on tribal property within the reservation, then imposing the tax on either the patron or the facility will work, because jurisdiction over non-members on fee land is not implicated. Any non-member who does not wish to pay the tax may simply choose not to stay at the facility.

However, in the instance where the tribe asserts HOT jurisdiction on facilities not owned by the tribe, but within the reservation, it would be wise to assess the land status of every hotel on the reservation. In the event there is a significant percentage of fee patent hotel sites, *Montana* and *Atkinson* must be considered. Similarly, in the event the sites are on leased trust land, the nature of the lease documents must be reviewed, paying attention to whether or not the documents authorize taxation, are silent on the matter, or preclude taxation. Where jurisdiction over the hotelier is tenuous, the tribal taxing authority

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[15] I have attached news clippings concerning the Confederated Salish and Kootenai Tribe's successful foreclosure of Montana taxes on its tribally owned, operated and managed resort, and the Rincon Band's similar success with its tribally owned and contractor-operated facility.
[16] None of this is intended as a criticism of the Yavapai Prescott Tribe, which at the time of the litigation had fewer than 200 tribal members, and was doing everything it could to advance the welfare of its people.
[17] *See,* WAC 458-20-192.

should look at the status of the hotel guests, and their means of access to the hotel: must they pass over Indian lands to arrive at the hotel?[18] Is there a significant nexus between the traveler and the Indian jurisdiction outside the state highway system? In that event it maybe provident to make the incidence of the tax on the traveler, and not the hotelier.

ii. The lowest risk case for a Tribal HOT

The lowest risk scenario for both supporting tribal taxing authority and eliminating competing state taxes is to impose the HOT on hotel property owned and operated by the Tribe, and held in trust by the United States. Where state taxation is concerned, the best approach post-*Yavapai* is to utilize tribal management, tribal employees, and tribally manufactured goods and services wherever possible. If you are in a jurisdiction where the incidence of the state tax falls on the lodger, then impose the tribal tax on the lodger as well.[19] Use the tax revenues for essential governmental services, and insure as much as possible that those services also benefit the Hotel.[20]

iii. Keep it simple

A HOT can be a simple statute. Avoid complex audit requirements by basing the tax on the room rate. If you intend to exempt certain categories of persons from the tax, then make the process for obtaining the exemption simple and verifiable without elaborate paper tracking. If you intend to utilize hotel "comps" as part of the tribal gaming enterprise, then consider either exempting "comps" from the tax, or shifting the incidence of the tax to the hotel, so that whether or not a comp has been issued for a room, the tribe receives the taxable value of the room rate.

E. Materials

1. Sample Ordinances

i. Navajo Nation Hotel Occupancy Tax
ii. Suquamish Tribe Hotel Occupancy Tax
iii. Confederated Tribes of Coos, Lower Umpqua and Siuslaw Indians Hotel Occupancy Tax
iv. Mashantucket Pequot Tribal Laws Hotel Occupancy Tax
v. Pokagon Band of Potawatomi Indians Hotel Tax

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[18] Prior to the Supreme Court's decision *in Strate v. A-1 Contractors*, it was easier to assert that customers had consented to a tax when entering the reservation, even if just by passing on the public roads. Post *Strate* and *Atkinson*, however, since state highway rights of way are treated as "the functional equivalent of fee lands" a careful *Montana* analysis is required.

[19] While the mere existence of dual taxation of the same subject is not a basis to strike down a state tax, the burden of dual taxation should be argued in any balancing test.

[20] While the provision of essential services to a non-member owned fee property will not support a Tribe's tax, the opposite is true: *Yavapai* considers the nature of the services the state provides to a tribal hotel as factors which might support state taxation.

2. News Clippings

i. "Suquamish Tribe To Begin Charging Lodging Tax" Kitsap Sun 11/16/2006
ii. Rincon Band "U.S. Judge Rules County Cannot Tax Tribe's Hotel" San Diego Union Tribune, 6/21/2005
iii. Confederated Salish and Kootenai Tribes "State Drops Suit Against Tribal Resort in Polson" AP 10/22/2002

3. Navajo Tax Commission Revenue Chart

4. *Atkinson Trading v. Shirley,* 532 U.S. 645 (2001).