Arizona Department of Economic Security

Appeals Board

Appeals Board No. T-1629122-001-B

ON-AUK-MOR TRADE CENTER LLC c/o MICHAEL NOVOTNY BIG FIRE LAW AND POLICY GROUP 1404 FT CROOK RD SOUTH BELLEVUE, NE 68005	STATE OF ARIZONA E S A TAX UNIT c/o SUSANNE CHYNOWETH ASSISTANT ATTORNEY GENERAL CFP/CLA 2005 NORTH CENTRAL AVE MAIL DROP CODE 1911 PHOENIX, AZ 85004
Petitioner	Department

IMPORTANT --- THIS IS THE APPEALS BOARD'S DECISION
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IMPORTANTE --- ESTA ES LA DECISIÓN DEL APPEALS BOARD
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RIGHT TO APPEAL TO THE ARIZONA TAX COURT

Under Arizona Revised Statutes, § 41-1993, the last date to file an Application for Appeal is ***** June 15, 2020 *****.

DECISION
REVERSED

The **PETITIONER** petitions for review of the Department's March 27, 2019 Reconsidered Determination of Unemployment Insurance Liability which held that the Petitioner is liable for Arizona Unemployment Insurance (UI) taxes under A.R.S. § 23-613.

The petition was filed on time, and the Appeals Board has jurisdiction under A.R.S. § 23-724.

The parties waived their right to an evidentiary hearing and agreed to have this matter decided by the Appeals Board based solely on the parties' written submissions, including documentary evidence. In accordance with the briefing schedule ordered by the Board on September 25, 2019, the Petitioner filed its Opening Brief on October 14, 2019, the Department filed its Response Brief on November 6, 2019, and the Petitioner filed its Rebuttal Brief on November 13, 2019.

The Petitioner offered exhibits P-1 through P-6 and the Department offered exhibits D-1 through D-10. The Appeals Board admits in evidence all the exhibits offered by the parties.

THE APPEALS BOARD FINDS the following facts based upon the record and the stipulation of the parties:

1. Petitioner is an Arizona domestic limited liability company (LLC).

2. Petitioner's sole member is the M. Family Trust.

3. M. Family Trust's sole trustee is D.M.

4. Petitioner's sole manager is D.M.

5. D.M. is a member of Salt River Pima-Maricopa Indian Community (SRPMIC).

6. D.M. resides on the SRPMIC.

7. Petitioner is not owned by SRPMIC or any subdivision or subsidiary of SRPMIC.

8. Petitioner is licensed to do business by SRPMIC.

9. Petitioner operates businesses located only and entirely within the SRPMIC.

10. Petitioner's operations are conducted entirely within Indian Country as that term is defined by 18 U.S.C. § 1151.

11. V.L. is not a member of SRPMIC.

12. Petitioner compensated V.L. for services she provided Petitioner from about July 1, 2016 through September 30, 2016.

13. Petitioner employed at least one individual for some portion of a day in each of 20 different calendar weeks in either calendar year 2019 or calendar year 2018, including non-consecutive weeks.

14. Petitioner, in any calendar quarter in either calendar year 2019 or calendar year 2018, paid for service in employment wages of $1,500 or more.

15. Petitioner engages in commercial transactions with the general public, including persons who are not tribal entities or members.

In addition to the facts set forth above, the parties stipulated to the following legal conclusion: the legal incidence of the Arizona unemployment compensation taxes under A.R.S. § 23-613 falls on employers.

We have carefully reviewed the record in this case and have considered the contentions raised in the petition.

The issue properly before this Board is whether the Petitioner is liable for Arizona Unemployment Insurance (UI) taxes under A.R.S. § 23-613.

This case presents important questions involving potentially conflicting public policies: tribal sovereignty versus Arizona's commitment, set forth in A.R.S.§ 23-601, to prevent the spread and lighten the burden of involuntary unemployment. In balancing these policies, we are guided by the Supreme Court's statement in *Montana v. Blackfeet Tribe*, 471 U.S.759,764 (1985), that "[t]he Constitution vests the Federal Government with exclusive authority over relations with Indian tribes...and in recognition of the sovereignty retained by Indian tribes even after formation of the United States, Indian tribes and individuals generally are exempt from state taxation within their own territory." The Court has also held that statutes are to be construed liberally in favor of the Indians, with ambiguous provisions interpreted to their benefit, *County of Yakima v. Confederated Tribes and Bands of the Yakima Indian Nation*, 502 U.S.251, 258 (1992). These principles form the background and the context for our consideration of the issues presented.

The Department's Reconsidered Determination (RD) found that V.L. was an employee of Petitioner and that Petitioner is an "employer" within the meaning of A.R.S. § 23-613, because Petitioner had gross payroll of at least $1,500 in a calendar quarter or employment of one or more employees for 20 weeks. The RD further found that there are no provisions of A.R.S. §§ 23-613, 23-613.01 or 23-617 stating that a business owned and operated by a tribal member is not an "employer" or that employment for such a business is exempt. Finally, the RD stated that 26 U.S.C. § 3309(d) makes UI coverage mandatory for tribal governments and business enterprises wholly owned by Indian tribes. The RD

concluded that because coverage is mandatory for Indian tribes, it must also be mandatory for privately owned businesses on tribal land, such as Petitioner.

Citing *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995) Petitioner argues that the Department lacks the jurisdiction, by virtue of federal law, to impose UI taxes on Petitioner.

Chickasaw identifies two different approaches used in Indian tax cases to determine the enforceability of a tax. The first approach, applied by the Court in *White Mountain Apache Tribe v Bracker*, 448 U.S. 136 (1980), is used if the legal incidence of the tax in question rests on non-Indians. When that is the case, federal, state, and tribal interests are balanced to determine whether the tax may be imposed. Under the *Bracker* test, a state will sometimes be permitted to impose a tax, particularly when the state interests involved are particularly strong. The second approach applies only if a tribe or tribal members bear the incidence of the tax. If that is true, a more categorical rule is used: absent clear congressional authorization, a State is without power to tax reservation lands and reservation Indians. Using the categorical rule, taxes will be invalid, unless there is clear congressional authority for the tax.

The parties stipulated that: (1) the sole trustee of the M. Family Trust is D.M.; (2) D.M. is a member of SPRMIC; (3) D.M. resides on SRPMIC; (4) Petitioner operates businesses located only and entirely within the SRPMIC; and (5) the legal incidence of the Arizona unemployment taxes under A.R.S. § 23-613 falls on employers. Petitioner contends that the Department has stipulated to all the elements necessary to trigger application of the *Chickasaw* categorical rule.

The final premise of Petitioner's argument is that Congress has not clearly authorized Arizona to impose UI taxes on businesses owned by tribal members. Petitioner cites *Montana v. Blackfeet Tribe*, 471 U.S. 759, 765 (1985) for the proposition that congressional authorization for a state to tax tribal members will be found only when the U.S. Congress has made its authorization "unmistakably clear." Petitioner cites numerous cases where no such authorization has been found and states that it finds nothing in the provisions of the Federal Unemployment Tax Act (FUTA) providing such authorization. Petitioner concludes that there is no unmistakably clear authorization for states to impose UI taxes on tribal member owned businesses.

Based on the foregoing, Petitioner concludes that the Department lacks the authority to impose UI taxes on the Petitioner.

The Department agrees that the legal incidence of Arizona's UI taxes falls on employers. However, the Department argues that the Petitioner, the employer in this case, is neither a tribe nor a member of a tribe. Therefore, Petitioner is a

non-Indian and, in determining the validity of the UI tax, the *Bracker* interest balancing test must be used rather than the *Chickasaw* categorical rule.

Citing *Turner v. City of Flagstaff*, 226 Ariz. 341, 247 P.3d 1011 (App. 2011), the Department argues that as an LLC, Petitioner is a separate legal entity from the M. Family Trust, its sole member. It is also separate from D.M., the sole trustee. The Department contends that Petitioner cannot be a member of the SRPMIC because under the tribe's constitution, only a natural person can be a member of the tribe. The Department concludes that because Petitioner is an LLC, the incidence of the tax falls on a non-Indian, thereby triggering application of the *Bracker* balancing test.

The position urged by the Department has been followed by at least one court in the context of Indian taxation. In *Baraga Prods. v. Comm'r of Revenue*, 971 F. Supp. 294 (W.D. Mich. 1997), the court considered whether a corporation was immune from a state value added tax. Although the corporation's sole shareholder was a tribe member, the Court held that the corporation could not be considered an enrolled member of the tribe. The court stated that a corporation was a legal entity distinct from its shareholders and that it could not take on the form of its shareholders in order to reduce tax liability.

While *Baraga* lends support to the Department's argument, other cases directly contradict it. In *Pourier v. S.D. Dep't of Revenue*, 2003 S.D. 21, 658 N.W.2d 395 (2003), the court considered whether the plaintiff, a corporation operated on an Indian reservation and owned by a registered tribe member, was entitled to a tax refund. The South Dakota Department of Revenue argued that as a corporation, the plaintiff cannot have the racial identity necessary to fall within the categorical *Chickasaw* rule. The court disagreed and held that "a corporation owned by the tribe or an enrolled tribal member residing on the Indian reservation and doing business on the reservation for the benefit of reservation Indians is an enrolled member for the purpose of protecting tax immunity." *Pourier* at 404.

In Arizona, courts have long shown a willingness to "pierce the corporate veil" when justice so requires and to recognize the acts and obligations of a corporation as those of a particular person. See, e.g., *Phx. Safety Inv. Co. v. James*, 28 Ariz. 514, 237 P. 958 (1925). Going beyond the corporate fiction to reach the people behind the corporate veil is especially appropriate where, as here, the business organization involved is an LLC. LLCs allow income to "pass through" to the owners, thereby demonstrating that, at least for some purposes, the LLC is not viewed as separate from the owner. Further, federal courts increasingly recognize that corporations can have a racial identity. *Thinket Ink Info. Res., Inc. v. Sun Microsystems, Inc.*, 368 F.3d 1053, 1059 (9th Cir. 2004) (finding that corporation can acquire "an imputed racial identity"); *Bains LLC v. Arco Prod. Co.*, 405 F.3d 764, 770 (9th Cir. 2005) (finding that corporation "undoubtedly acquired an imputed racial identity"). Thus, in limited and

appropriate circumstances, there is no reluctance to disregard the legal fiction of the business organization as a separate entity and to recognize the natural persons involved with the management and ownership of the company as the real parties in interest.

Of particular importance are public policy considerations favoring tribal economic development:

> Congress enacted numerous pieces of legislation since the 1970s to encourage tribal economic development and ease tax burdens on Indian tribes. In each piece of legislation, Congress made findings of fact and strong statements of support for tribal economic development. For Congress, the long-term solution to tribal dependence on federal programs lies in reservations with economic strength. Congress's recent commitment to encouraging tribal economic development has been unwavering. (footnotes omitted) Matthew L.M. Fletcher, The Supreme Court and Federal Indian Policy, 85 Neb. L. Rev. 121, 145 (2006).

The Supreme Court has stated that congressional federal Indian policy in favor of "tribal self-sufficiency and economic development" is "overriding." *New Mexico v. Mescalero Apache Tribe*, 462 U.S. 324, 335 n.17 (1983). Reflecting that emphasis, the court in *Pourier,* recognized that the policy favoring tribal economic development weighs heavily in favor of treating an Indian owned business organization as a tribal member. The Court stated: "Congress' primary objective in Indian law for several decades has been to encourage tribal economic independence and development. By finding that incorporation under state law deprives a business of its Indian identity, we would force economic developers on reservations to forgo the benefits of incorporation in order to maintain their guaranteed protections under federal Indian law. This could hinder economic development." *Pourie*r at 405.

Therefore, considering especially the public policy ramifications of our decision, we conclude that the Petitioner is a tribal member. Because the legal incidence of the UI tax falls on the Petitioner, a tribal member, the *Chickasaw* categorical test applies.

The Department next argues that Arizona's UI contributions are neither taxes nor excise taxes. The Department contends that taxes are forced contributions the state collects to support government and all public needs. *Hunt v. Callahan*, 32 Ariz. 235, 239 (1927). Further, excise taxes are imposed on merchandise or commodities. *Powell v. Gleason*, 50 Ariz. 542 (1937). The Department concludes that UI contributions are not taxes or excise taxes because they are based on wages, not commodities or sales and they are for a very specific purpose and do not support the general state budget.

The Federal Unemployment Tax Act (FUTA) explicitly refers to the federal tax that employers pay to the federal government for the unemployment insurance program as an "excise tax." 26 U.S.C § 3301. In addition, there are numerous cases where the courts refer to the federal FUTA tax as an excise tax. *California v. Grace Brethren Church*, 457 U.S. 393, 102 S. Ct. 2498, 73 L.Ed.2d 93 (1982); *Bowman v. Stumbo*, 735 F.2d 192 (6th Cir. 1984). Furthermore, at least one state court has classified state contributions as excise taxes. *Cal. Emp't Com. v. MacGregor*, 64 Cal. App. 2d 691, 149 P.2d 304, 306 (1944).

The payments made by employers as contributions to the state unemployment insurance fund are quite similar to the federal FUTA taxes. Both the federal taxes and the state contributions are payments made by employers to the government to support the Unemployment Insurance program. Both payments are transactional, based on the exchange of labor for wages. While these payments may be somewhat unlike other excise taxes, the FUTA tax is clearly an excise tax. And given the similarity between the FUTA tax and state contributions, we conclude that state contributions are also properly classified as excise taxes.

Finally, the Department argues that, applying *Bracker*, the balance of the interests favors requiring Petitioner to pay Arizona's UI tax. However, because we have concluded that the *Chickasaw* categorical analysis applies in this case, and the *Bracker* balancing analysis does not, we find it unnecessary to address the Department's contentions in this regard.

Under *Chickasaw,* Arizona may not impose a tax on tribal owned businesses if the incidence of the tax falls on Indians, unless the tax is unmistakably authorized by Congress. The Department has not cited to any such authorization and we have found none. Although the Petitioner is an LLC, we conclude it is an enrolled member of the tribe for purposes of determining the enforceability of the UI tax. Therefore, the incidence of the tax falls on a tribal member and we conclude that the Department may not impose the UI tax on Petitioner. Accordingly,

THE APPEALS BOARD **REVERSES** the Department's March 27, 2019 Reconsidered Determination of Unemployment Insurance Liability based upon the evidence of record.

The Petitioner is not liable for Arizona Unemployment Insurance (UI) taxes under A.R.S. § 23-613.

DATED: 5/14/2020

APPEALS BOARD

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