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Wagnon v. Prairie Band Potawatomi Nation: State Tax on Motor Fuels Distributed to Indian Tribal Retailers

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Summary

On October 3, 2005, the U.S. Supreme Court heard oral arguments in *Wagnon v. Prairie Band Potawatomi Nation* (No. 94-631), which tests whether Kansas may apply its motor fuels tax to gasoline sold by off-reservation distributors to Indian tribal retailers for on-reservation sales. While the Court has consistently upheld state authority to tax on-reservation tobacco and gasoline sales to non-tribal members, tribal sovereign immunity bars states from collecting such taxes directly from Indian tribes. The Kansas tax is designed to resolve this problem by imposing the tax on the non-Indian, off-reservation distributor. The appellate court found the state tax to be preempted by the federal interest in tribal sovereignty and economic development. Although legislation has been introduced in several recent Congresses to compel tribes to remit state sales taxes on retail sales to non-Indians, to date no such requirement has been enacted. This report will be updated upon the issuance of a Supreme Court decision.

Background. Near its casino, the Prairie Band Potawatomi Nation (Tribe) operates a convenience store which sells gasoline and diesel fuel, purchased from and brought to the reservation by a non-Indian off-reservation distributor. Sales to casino patrons and employees account for almost 75% of the fuel sold; sales are subject to a tribal tax yielding $300,000 annually that is used for reservation roads.[1] The Kansas Motor Fuel Tax Act of 1995[2] taxes all fuels "used, sold, or delivered" in Kansas.[3] It specifies that the legal incidence of the tax, which generally means the duty of paying the tax, falls on the distributor[4] and that receipts are to be used to maintain the state's highway

[1] *Prairie Band Potawatomi Nation v. Richards*, 241 F. Supp. 2d 1295, 1297-1298 (D. Kan. 2003).

[2] Kan. Stat. Ann. §§ 79-3401 et seq.

[3] Kan. Stat. Ann. § 79-3408(a) (Supp. 2003).

[4] Kan. Stat. Ann. § 79-3408(c) (Supp. 1003).

system.[5] The distributor is permitted to pass the tax along to the retailer, who, in turn, may include it in the price at the pump. Tribal members may seek a refund of state taxes included in the gasoline that they buy on the reservation.[6] The Tribe, claiming that the Kansas tax is preempted, sought a federal court injunction against the enforcement of the tax with respect to fuels distributed to its tribal retailer. The district court ruled in favor of Kansas,[7] and the court of appeals reversed.[8]

At the Supreme Court level, the case, *Wagnon v. Prairie Band Potawatomi Nation* (No. 94-631), presents the question of whether Kansas may apply its motor fuels tax to fuels distributed by off-reservation wholesalers to Indian tribal retailers for on-reservation sale. The Kansas Department of Revenue (Kansas) argues that the case should be decided in line with other rulings on taxing off-reservation activity of Indian tribes. The Tribe contends that the tax impacts the tribe's ability to impose its own tax because the tribal retailer will pass the tax along to reservation customers and, therefore, the case should be decided in light of decisions involving non-Indians doing on-reservation business with a tribe. The Supreme Court is likely to look closely at the issue of where the legal incidence of the tax falls. According to its decision in *Oklahoma Tax Commission v. Chickasaw Nation* (*Chickasaw Nation*), "[i]f the legal incidence of an excise tax rests on a tribe or on tribal members for sales made inside Indian country, the tax cannot be enforced absent clear congressional authorization."[9] Complicating the issue in this case may be the fact that although the tax statute specifies that its legal incidence falls on the distributor, the Kansas Supreme Court has held otherwise.[10]

At one time, tribes and reservations were insulated from the reach of state law,[11] but that principle has been eroded with shifting federal Indian policy[12] and the end of the exclusively Indian character of the reservations. Currently, jurisdiction is shared by federal, state, and tribal governments. State authority within "Indian country,"[13] over

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[5] Kan. Stat. Ann. § 79-3402 (1997).

[6] See *Kaul v. Kansas Department of Revenue*, 266 Kan. 464,466; 970 P. 2d 60, 62-63 (Kan. 1998), *cert. denied*, 528 U.S. 812 (1999).

[7] *Prairie Band Potawatomi Nation v. Richards*, 242 F. Supp. 2d 1295 (D. Kan. 2003).

[8] *Prairie Band Potawatomi Nation v. Richards*, 379 F. 3d 979, 982 (10th Cir. 2004).

[9] 515 U.S. 450, 459 (1995).

[10] *Kaul v. Kansas Department of Revenue*, 266 Kan. 464: 970 P. 2d 60 (Kan. 1998), *cert. denied*, 528 U.S. 812 (1999).

[11] *Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 17 (1831) (an Indian nation is not a foreign nation, but a "domestic dependant nation"); *Worcester v. Georgia*, 31 U.S. (6 Pet.) 515 (1832) (law of Georgia does not reach to Indian country within the state).

[12] See, F. S. Cohen, *Handbook of Federal Indian Law* 47-206 (1982 ed,), which divides federal Indian policy into the following eras: 1789-1871 (formative); 1871-1928 (allotment); 1928-1942 (Indian reorganization); 1943-1961 (termination) and 1961-present (self-determination).

[13] "Indian country" is defined in 18 U.S.C. § 1151, to include "all land within the limits of any Indian reservation under the jurisdiction of the United States Government, notwithstanding the issuance of any patent, and including right-of-way running through the reservation, (b) all dependent Indian communities within the borders of the United States... and (c) all Indian

persons not belonging to an Indian tribe[14] and tribal authority over nonmembers doing business with a tribe on its reservation[15] have been upheld by the courts. Although state retail sales taxes on tribal sales to nonmembers have been upheld,[16] collecting these taxes has been difficult without tribal cooperation because tribal sovereign immunity bars states from suing tribes to recover taxes owed for sales to non-Indians. In *Oklahoma Tax Commission, v. Citizen Band Potawatomi Indian Tribe*,[17] the Supreme Court indicated various means for states to enforce such taxes, including collecting the sales tax from the wholesalers, which is essentially what Kansas is attempting to do in this case.

Preemption Analysis. Preemption analysis begins with the Supremacy Clause of the U.S. Constitution,[18] under which Congress may override state laws in conflict with its exercise of delegated powers. If Congress enacts legislation under one of its delegated powers that includes an explicit statement that state law is preempted, the Supreme Court generally will give effect to that legislative intent.[19] Where there is no language of preemption, the Court is likely to find preemption when it identifies a direct conflict between the federal law and the state law or when it concludes that the federal government has so occupied the field as to preclude enforcement of state law with respect to the subject at hand.[20] In cases involving assertion of state authority over activities on Indian lands, in the absence of a federal statute specifically addressing the issue or a federal regulatory regime occupying the field, the Court is likely to examine the state interest in relation to the federal interest in tribal self-government.

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[13] (...continued)
allotments...."

[14] See *County of Yakima v. Confederated Tribes and Bands of the Yakima Indian Nation*, 502 U.S. 251 (1992); *Brendale v. Confederated Tribes and Bands of the Yakima Indian Nation*, 492 U.S. 408 (1989); *Strate v. A-1 Contractors*, 520 U.S. 438 (1997).

[15] The most authoritative statement can be found in *dicta* in *Montana v. United States*, 450 U. S. 544 , 565 (footnotes omitted)(1981):

> Indian tribes retain sovereign power to exercise some form of civil jurisdiction over non-Indians on their reservations, even on non-Indian fee lands. A tribe may regulate through taxation, licensing, or other means nonmenbers who enter consensual relationships with the tribe or its members, through commercial dealing, contracts, leases, or other arrangements.... A tribe may also retain inherent power to exercise civil authority over the conduct of non-Indians on fee lands within its reservation when that conduct threatens or has some direct effect on the political integrity, the economic security, or the health or welfare of the tribe.

[16] *Moe v. Confederated Salish and Kootenai Tribes*, 425 U.S. 464 (1976); *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134 (1980); and *Department of Taxation and Finance v. Milhelm Attea & Bros., Inc.*, 512 U.S. 61 (1994).

[17] 498 U.S. 505, 514 (1991).

[18] U.S. Const., Art. VI, cl. 2, declares that the Constitution and "the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

[19] *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 605 (1991).

[20] CRS Report 97-589, *Statutory Interpretation: General Principles and Recent Trends*, by George Costello.

On-Reservation Sales to Nonmembers: Cases. Tribes have authority to tax tribal members and their property on reservations[21] and to tax nonmembers under certain circumstances.[22] On-reservation activities of Indian tribes and their members are generally immune to state taxation unless Congress has explicitly authorized the taxation.[23] Although there is a federal law, the Hayden-Cartwright Act, which permits states to tax gasoline sold on federal lands, including "United States military or other reservations,"[24] the question of whether the law applies to Indian reservations is not before the Court in this case.[25] The Court has found state taxes inapplicable to on-reservation sales to tribal members,[26] but it has permitted state taxation of on-reservation sales to nonmembers when the basic argument favoring federal preemption is merely that the economic impact of the state tax renders tribal sellers unable to compete with off-reservation vendors who charge only the state tax and not the additional tribal tax.[27] If the Court locates the legal incidence of a state tax with the non-Indian purchaser and finds no explicit statutory preemption, it looks for implied preemption by examining the factual circumstances and any federal statutory backdrop to determine whether there is a federal preemptive interest in tribal self-government and economic development. It looks for more than tribal sales that amount to marketing an exemption from state taxes and encouraging nonmembers to flout their obligations to pay state taxes.[28] The Court may also frame its inquiry in terms of whether the state tax infringes on tribal self-government.[29] It may look to whether or not the state tax disturbs a market that is intrinsic to the reservation, i.e., whether the state is attempting to tax a tribal product.[30]

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[21] *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 152(1980) (tribal retail sales tax on cigarettes sold on-reservation to nonmembers); *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982) (mineral severance tax on minerals extracted from tribal reservation under a leasing agreement with the tribe).

[22] The Supreme Court, in *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 152, (1980), upheld the authority of a tribe to tax on-reservation cigarette sales to nomembers as implicit in retained tribal sovereignty.

[23] See, e.g., *McClanahan v. Arizona State Tax Comm'n* , 411 U.S. 164 (19783) (state net income tax); *Bryan v. Itasca County*, 426 U.S. 373 (1976) (personal property tax); *Moe v. Confederated Salish & Kootenai Tribes*, 425 U.S. 463 (1976) (on reservation retail cigarette sales to tribal members).

[24] 4 U.S. C. § 104(a).

[25] The courts that have dealt with the question have found that it does not apply to Indian reservation lands. *Coeur D'Alene Tribe v. Hammond*, 1224 F. Supp. 2d 1264 (D. Idaho 2002); *Goodman Oil Co. Of Lewiston v. Idaho State Tax Comm'n*, 135 Idaho 53, 28 P. 3d 996 (2001), *cert. denied*, 534 U.S. 1129 (2002) .

[26] *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134 (1980).

[27] *Moe v. Confederated Salish and Kootenai Tribes*, 425 U.S. 463 (1976); *Washington v. Confederated Tribes of the Colville Indian Reservation,*, 447 U.S. 134 (1980); and, *Department of Taxation and Finance v. Milhelm Attea & Bros., Inc.*,512 U.S. 61 (1994).

[28] *Washington v. Confederated Tribes of the Colville Indian* Reservation, 447 U.S. 134, 155.

[29] See *Williams v. Lee*, 358 U.S. 217 (1959).

[30] The Court has said that "while the Tribes do have an interest in raising revenues for essential governmental programs, that interest is strongest when the revenues are derived from value

(continued...)

State Taxation of Off-Reservation Tribal Activities. Off-reservation activities of tribes are subject to state taxing authority. The leading case is *Mescalero-Apache Tribe v. Jones*,[31] in which the Court stated a standard: "[a]bsent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State."[32]

Taxation of Nonmember Entities Doing Business With Tribes. *Montana v. United States*[33] denies to Indian tribes broad authority over nonmembers within a tribal reservation except in certain situations among which are taxing those who enter into consensual relations with a tribe. A business contracting with a tribe falls into this category and is subject to tribal taxes,[34] and such a contractor may also be subject to state taxation provided a balancing of federal, state, and tribal interests favors a state tax. If the federal regulatory scheme is pervasive, it may eliminate any taxing state authority. Such was the ruling of the Court with respect to the Indian timber harvesting regime in *White Mountain Apache Tribe v. Bracker*.[35] If the state interest is no more than revenue raising, the balance may weigh against the state tax.[36] If, however, the state can show that the state has some involvement with the reservation activity to be taxed other than revenue raising, the tax may be upheld if it is found to have a less than substantial effect upon tribal self-government and held not to be exorbitant.[37]

Trial and Appeals Court Opinions. The district court, in *Wagnon*,[38] began with the premise that the legal incidence of the motor fuels tax fell on the non-Indian distributor. It then relied on *Chickasaw Nation* and presumed state taxing authority valid unless the Tribe could show that there was a federal law prohibiting state taxation

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[30] (...continued)
generated on the reservation by activities involving the Tribes and when the taxpayer is the recipient of tribal services. The State also has a legitimate governmental interest in raising revenues, and that interest is likewise strongest when the tax is directed at off-reservation value and when the taxpayer is the recipient of state services." *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 156-157.

[31] 411 U.S. 145 (1973).

[32] Id., at 148-149.

[33] 450 U.S. 544 (1981).

[34] *Merrion v. Jicarillla Apache Tribe*, 455 U.S. 130 (1982).

[35] 448 U.S. 136 (1980).

[36] The tribe had conceded that the state had authority to impose the tax for use of state roads within the reservation. Id., at 140, n. 6

[37] This seems to be the holding in *Cotton Petroleum v. New Mexico*, 490 U.S. 163 (1989), in which the Court found that the State of New Mexico was entitled to impose a mineral severance tax on minerals withdrawn from Indian lands within the Jicarilla Apache Reservation by a non-Indian concern under contract with the tribe. Contrast that with *Ramah Navajo School Board v. Bureau of Revenue*, 458 U.S. 832 (1982), which found that the state services were insufficient to justify application of state tax to tribal contractor building a tribal school for a tribe on-reservation.

[38] At the district and appellate court levels, the case was styled *Prairie Band Potawatomi Nation v. Richards.* See supra, n. 7 and 8.

or that there was something other than the Tribe's general interest in economic development to outweigh Kansas' interest in raising revenue from nonmembers doing business in the state. The court was not persuaded to distinguish the case from *Colville* because of the relationship between the gasoline sales and the Tribe's casino but identified as present in the case what it considered to be the salient factors in *Colville*, non-Indian customers buying non-Indian produced goods and benefitting from services funded by the Kansas taxes.[39] Because the court concluded that the tax fell mainly on persons who were recipients of state services, it refused to find that the Tribe's right to self-government was infringed or that the economic effect of the tax on the Tribe's revenue was grounds for invalidating the state tax. It, therefore, found that the balancing of interests favored Kansas so greatly that a summary judgment in its behalf was in order.

The court of appeals described the tax as "a tax on motor fuels distributed to Indian lands," structured to have its legal incidence fall on non-Indian distributors[40] off-reservation before any tribal retailer arranged to purchase the motor fuels. It used the balancing test applicable to on-reservation transactions and found the tribal and federal interests to outweigh those of Kansas. It distinguished the case from *Colville* because the fuel was being offered at market prices to customers mainly patronizing or working at the tribal casino which it considered to be reservation-generated value. Other factors affecting the court's analysis were: (1) the negative impact of the Kansas tax on the Tribe's ability to raise revenue; (2) the Tribe's need for such revenue to maintain its infrastructure, including tribal roads leading to the casino and gasoline station; (3) the alignment of strong federal interests in tribal self-determination with tribal interests; and (4) the fact that Kansas' interest is limited to general revenue raising.

Legislation. Efforts in several recent Congresses to enact legislation to compel tribes to remit state sales taxes on retail sales to non-Indians[41] have not succeeded; nor has any such legislation been introduced in this Congress.

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[39] See also *Salt River Pima-Maricopa Indian Community v. Arizona* 50 F. 3d 734 (9th Cir. 1995).

[40] *Prairie Band Potawatomi Nation v. Richards*, 379 F. 3d 979, 982 (10th Cir. 2004).

[41] See, e.g., H.R. 1168, H.R. 3966, and H.Amdt. 236 to H.R. 2107 (105th Cong); S. 550 (106th Cong.); and, H.R. 2726 (107th Congress).