The Tribal Tax Man Cometh—Recent Developments in Indian Taxation Law

by Rob Roy Smith

Idaho is one of three jurisdictions currently on the front lines of Indian tax development. Recent cases indicate judicial willingness to further insulate tribes from state taxation while supporting tribes' power to tax non-Indians.

When the average American uses the oft repeated phrase "In this world, nothing is certain but death and taxes,"[1] If they are not thinking of tribal taxes, perhaps they should be.

One of the powers essential to the maintenance of any government is the power to levy taxes, and for Indian tribes, this is no exception. Indian self-sufficiency and self-government are dependent upon a tribe's ability to raise its own revenues. When a government chooses to exercise its power to tax, it must do so effectively, without unreasonable interference from other governments. If another sovereign can defeat its taxing power on legal grounds, or injure or destroy its tax base, the government's taxing power would be useless.

For decades, Indian tribes found themselves in the unenviable position of a government without a viable tax base, unable to assert this inherent power of sovereignty. However, times are changing. Recent cases from Idaho, Washington, and the Midwest reflect the further progression of Indian tax law in favor of insulating tribes and tribal businesses from state taxation, and affirming the authority of tribes to extend their sovereign taxing jurisdiction over non-Indians.

General Indian Law Taxation Principles

There are several general tenants of Indian tax law. First, there are limits on state authority to impose a tax on Indian tribes or tribal members. If the legal incidence of a state tax (*i.e.* the legal liability to remit a tax to the state) falls upon a tribe or tribal members for sales made within Indian country, the imposition of the state tax is *per se* unenforceable and categorically barred as a matter of federal law.[2] However, the same state tax that imposes the legal incidence on consumers, thereby forcing the tribe to collect and remit the tax that falls on non-Indians, is not preempted as a matter of law.[3] Where the legal incidence of a tax falls on a tribe outside the reservation, the state tax may be preempted if the "balance of federal, state, and tribal interests" favors the tribe or if the state tax threatens the tribe's rights of self-governance.[4] A related doctrine applying these balancing principles to preempt state taxes is known as "value generated on the reservation," which considers the degree of federal regulation involved, the respective governmental interests of the tribes and states, and who provides services to the party the state seeks to tax.[5]

Second, it is unquestioned that a tribe can tax tribal businesses and its own members. The power to tax nonmembers within the reservation is narrower. Generally, unless expressly permitted by Congress[6], a tribal tax on a non-Indian transaction or activity occurring within the boundaries of a reservation will generally be upheld against a court challenge only if: (1) the transaction being taxed takes place on trust land; or (2) the transaction or activity being taxed takes place on non-Indian fee land and either (a) the non-Indian is involved in a formal consensual relationship (*e.g.*, a contract) with the tribe or its members; or (b) the impact of the transaction or activity on the tribe is demonstrably serious and imperils the political integrity, economic security, or health and welfare of the tribe.[7]

With these general principles well established, the facts of each case determine the legality of the sovereign's taxation scheme. In light of the recent downturn in the economy, it is not surprising that both tribes and states have sought new ways to impose their taxes on the other. In a few recent cases, the tribes are coming out the winners.

Tribal Taxation of Non-Indians – Utility Taxes

A prime example of a tribe's lawful taxing interest in the affairs of non-Indians is tribal utility taxes. The foundation for tribal utility taxes was laid by the Ninth Circuit Court of Appeals four years ago in *Big Horn Electric v. Adams*,[8] a case concerning a tribal *ad valorem* tax on utility property located on a power company's right-of-way on the Crow Reservation. The electric company argued that the tribe lacked the power to tax because the right-of-way was equivalent to nonmember fee land and, therefore, beyond the reach of the tribe's regulatory jurisdiction. The Ninth Circuit determined that the tribe's *ad valorem* tax was invalid and exceeded the tribe's jurisdiction because the tax was not imposed on the activity that formed the consensual relationship. Importantly, however, the court held that the sale of electric power to the Tribe by the utility was taxable because there was a consensual relationship.

Following this decision, three tribes in Washington enacted tribal utility taxes—the Swinimish Indian Tribal Community, the Lummi Nation, and the Yakama Indian Nation. These taxes have withstood judicial review in both administrative and state courts in Washington.[9] These rulings stand for the proposition that tribal utility taxes—on services ranging from the provision of telecommunications and electrical power to solid waste collection—are valid under the United States Supreme Court's decision in *Atkinson* and the Ninth Circuit's decision in *Big Horn Electric*. Tribal utility taxes are business taxes, not franchise fees, and, therefore, the utility's payment of the taxes may be recovered from all ratepayers who live within the reservation, regardless of whether they are Indian or non-Indian. The tax is on the retailer with whom the tribes have a formal consensual relationship, not the consumer. A similar tax imposed by Idaho tribes on utility retailers, and passed onto the consumer by the utility, may be sustained on similar grounds.

Freedom from State Taxation–Motor Fuels Taxes

Freedom from state taxation has myriad benefits. Most obviously, tribal retailers can obtain a competitive advantage against non-Indian businesses by offering the same services for a reduced

fee. More importantly, however, the absence of a state tax allows a tribe to fill the regulatory gap and impose its own tax on Indian and tribal retailers that is commensurate with the state tax. These revenues can be used by the tribes to fund governmental services. Nowhere are these issues being played out more than in the field of motor fuels taxation.

Idaho has been at the center of the Indian fuels tax litigation for the last four years. The debate began with the Idaho Supreme Court's 2001 decision in *Goodman Oil v. Idaho State Tax Comm'n*,[9] declaring Idaho's motor fuels tax invalid as applied to Indian and tribal gasoline retailers on Indian lands. The *Goodman* Court found the state tax invalid because the incidence of the state tax was on the retailer, here a tribe within Indian country, without congressional approval.

Following the decision, the Coeur d'Alene, Nez Perce, and Shoshone-Bannock tribes enacted their own fuels taxes on tribal and Indian retailers within their reservations. The Idaho legislature responded on March 23, 2002, by purporting to shift the legal incidence of the state tax to non-Indian distributors.[11] This prompted the three tribes to sue the state in federal court, arguing, among other things, that the state legislature failed to shift the legal incidence of the tax and that the tax remained categorically barred as a direct tax on tribes within Indian country. The Idaho District Court agreed.[12] In August 2004, the Ninth Circuit affirmed, enjoining Idaho from collecting the state motor fuels tax from tribal and Indian retailers operating on reservations because the legal incidence of the state tax fell on the tribes without congressional authorization.[13] However, the Ninth Circuit may not have the last word. Idaho will likely petition the United States Supreme Court for certiorari. What happens next is anyone's guess. However, lest you think the Ninth Circuit stands alone, no other court to address the issue has upheld a similar state taxation scheme, and the U.S. Supreme Court has consistently refused to tackle the issue.[14]

Also in the midst of the Indian fuels tax debate is the state of Kansas. Two recent cases from the Tenth Circuit are important for Idaho tribes considering operating retail gasoline stations, and may signal a favorable expansion of a long-standing Indian tax law principle.

The first case is *Winnebago Tribe v. Kline*.[15] The plaintiff is the Winnebago Tribe of Nebraska, which owns and operates a tribal fuel distribution company, Ho-Chunk Incorporated Distribution ("HCI"). HCI purchases fuel in Nebraska and Iowa and transports the fuel to the Winnebago reservation, where HCI blends in an alcohol additive and conducts sales of its fuel. Some of the fuel is sold to tribes in Kansas, whereupon HCI imports the fuel to tribal retail stations in that state.

The Kansas state motor fuels tax falls on the "distributor of first receipt" within the state.[16] When Kansas attempted to impose its tax on HCI, HCI refused to pay the tax and the tribe brought suit to block the state's collection efforts.

The Tenth Circuit granted the tribe's request for an injunction, finding that Kansas likely lacked authority to tax the sale of fuel between the Winnebago Tribe and the Kansas tribes because HCI sold the fuel to the tribes in Kansas **before** it entered Kansas and was therefore importing, not distributing, the gasoline.[17] Trial is pending to determine whether the state taxes apply and whether blending in the additive may provide "value added on the reservation." Should Idaho shift the legal incidence of its state motor fuels tax from retailers to distributors to address the *Hammond* ruling, a similar relationship (where a tribal distributor enters the state importing fuel already owned by Idaho tribes) may preempt the state tax.

The second case of interest in Kansas is the recent Tenth Circuit decision in *Prairie Band Potawatomi Nation v. Richards*, which involves the same Kansas tax.[18] In contrast to *Winnebago*, where the fuel was distributed by a tribal distributor, *Prairie Band* addressed whether Kansas could tax a non-Indian distributor delivering fuel to a Kansas tribe. Applying a balancing test, the Tenth Circuit invalidated the state tax as applied to the tribe, relying heavily on the fact that the tribe's fuel revenues are derived from "value generated" on its reservation. The court focused on the close nexus between the tribe's fuel sales and its gaming enterprise, and in a highly fact-specific opinion, noted the following factors as key to its determination: (1) the retail gasoline station is built on trust land next to the casino; (2) the station is tribally owned and eleven of its fifteen employees are Indians; (3) seventy-three percent of the fuel station's customers are either casino patrons or casino employees, and another eleven percent live or work on the reservation; (4) the station sells fuel at fair market prices; (5) the station created a new fuel market for an otherwise remote community; and (6) the tribe's tax provides revenues to cover the costs of maintaining the access road from the highway to the tribe's casino (which Kansas does not maintain).[19]

Prairie Band is important for two reasons. First, it recognizes that a tribe's interests in selling fuel free of state taxes may outweigh state interests regardless of whether the state tax is imposed on tribal or non-Indian fuel distributors serving tribal retail gasoline stations. Second, *Prairie Band* is important for its logical extension of the "value generated on the reservation" preemption doctrine. Before *Prairie Band*, a tribe had to make the **product** and be substantially involved in its sale to take advantage of value added preemption.[20] *Prairie Band*, however, recognizes that tribes may only have to create a **market** for the goods it sells to be eligible for value added preemption. This is an important recognition of the realities of economic development in Indian country. Stay tuned, however, as this case too may be subject to a writ of certiorari from the state.

This is an exciting time in Indian tax law. New taxing tensions and new opportunities arise each day as more non-Indian businesses relocate to Indian country to take advantage of a burgeoning market. As the five federally recognized tribes in Idaho continue their economic growth, Idaho will remain on the cutting edge of these important issues.

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