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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 December 6, 2005, the U.S. Supreme Court, in *Wagnon v. Prairie Band Potawatomi Nation* (No. 94-631), upheld the application of a non-discriminatory Kansas motor fuels tax to gasoline sold by off-reservation distributors to Indian tribal retailers for on-reservation sales. Important to the Court's reasoning were: (1) the fact that the state law specified that the legal incidence of and the liability for paying the tax fell on the distributor; (2) that the transaction being taxed—the receipt of the motor fuels in Kansas by the distributor—took place off-reservation; and (3) that the state taxes were being passed on to beneficiaries of state services—the non-Indian patrons of the tribal gasoline operation and its gaming casino. *Wagnon* follows a series of cases that have upheld state authority to tax on-reservation tobacco and gasoline sales to non-tribal members, but which have raised questions about the ability of states to collect these taxes because of the bar that tribal sovereign immunity imposes to enforcement actions against Indian tribes. 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 not be updated.

Background. In *Wagnon v. Prairie Band Potawatomi Nation* (No. 94-631), the Supreme Court, on December 6, 2005, upheld the application of a non-discriminatory Kansas motor fuels tax to gasoline sold by off-reservation distributors to Indian tribal retailers for on-reservation sales against a claim that the tax was preempted by operation of federal law. At one time, tribes and reservations were insulated from the reach of state law,¹ but that principle has been eroded with shifting federal Indian policy² and the end

¹ *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).

² 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 (continued...)

of the exclusively Indian character of the reservations. Currently, jurisdiction is shared by federal, state, and tribal governments. State authority within “Indian country,”³ over persons not belonging to an Indian tribe⁴ and tribal authority over nonmembers doing business with a tribe on its reservation⁵ have been upheld by the courts. Although state retail sales taxes on tribal sales to nonmembers have been upheld,⁶ 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*,⁷ the Supreme Court indicated various means for states to enforce such taxes, including collecting the sales tax from the wholesalers, which is essentially what the Kansas statute does in this case.

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.⁸ The Kansas Motor Fuel Tax Act of 1995⁹ taxes all fuels “used, sold, or delivered” in Kansas.¹⁰ It requires that the “tax ... be computed on all motor-vehicle fuels ... received by each distributor, manufacturer or

² (...continued)

(Indian reorganization); 1943-1961 (termination) and 1961-present (self-determination).

³ “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 allotments....”

⁴ 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).

⁵ 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 nonmembers 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.

⁶ *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).

⁷ 498 U.S. 505, 514 (1991).

⁸ *Prairie Band Potawatomi Nation v. Richards*, 241 F. Supp. 2d 1295, 1297-1298 (D. Kan. 2003).

⁹ Kan. Stat. Ann. §§ 79-3401 et seq.

¹⁰ Kan. Stat. Ann. § 79-3408(a) (Supp. 2003).

importer in this state”¹¹ It specifies that the legal incidence of the tax, which generally means the duty of paying the tax, falls on the distributor¹² and that receipts are to be used to maintain the state’s highway system.¹³ 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.¹⁴ 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,¹⁵ and the court of appeals reversed.¹⁶

Preemption Analysis. Preemption analysis begins with the Supremacy Clause of the U.S. Constitution,¹⁷ 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.¹⁸ 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.¹⁹ 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.

Tribes have authority to tax tribal members and their property on reservations²⁰ and to tax nonmembers under certain circumstances.²¹ On-reservation activities of Indian

¹¹ Kan. Stat. Ann. § 79-3408(c).

¹² Kan. Stat. Ann. § 79-3408(c) (Supp. 1003).

¹³ Kan. Stat. Ann. § 79-3402 (1997).

¹⁴ 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).

¹⁵ *Prairie Band Potawatomi Nation v. Richards*, 242 F. Supp. 2d 1295 (D. Kan. 2003).

¹⁶ *Prairie Band Potawatomi Nation v. Richards*, 379 F. 3d 979, 982 (10th Cir. 2004).

¹⁷ 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.”

¹⁸ *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 605 (1991).

¹⁹ CRS Report 97-589, *Statutory Interpretation: General Principles and Recent Trends*, by George Costello.

²⁰ *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).

²¹ 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

tribes and their members are generally immune to state taxation unless Congress has explicitly authorized the taxation.²² The Court has found state taxes inapplicable to on-reservation sales to tribal members,²³ 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.²⁴ 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.²⁵ The Court may also frame its inquiry in terms of whether the state tax infringes on tribal self-government.²⁶ 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.²⁷

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*,²⁸ 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."²⁹

²¹ (...continued)

nonmembers as implicit in retained tribal sovereignty.

²² See, e.g., *McClanahan v. Arizona State Tax Comm'n*, 411 U.S. 164 (1978) (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).

²³ *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134 (1980).

²⁴ *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).

²⁵ *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 155.

²⁶ See *Williams v. Lee*, 358 U.S. 217 (1959).

²⁷ 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 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.

²⁸ 411 U.S. 145 (1973).

²⁹ *Id.*, at 148-149.

Taxation of Nonmember Entities Doing Business With Tribes. *Montana v. United States*³⁰ 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,³¹ 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 state taxing authority. Such was the ruling of the Court with respect to the Indian timber harvesting regime in *White Mountain Apache Tribe v. Bracker*.³² If the state interest is no more than revenue raising, the balance may weigh against the state tax.³³ 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.³⁴

Supreme Court Decision in *Wagnon v. Prairie Band Potawatomi Nation*.

The Kansas Department of Revenue (Kansas) had argued that the case should be decided in line with other rulings on taxing off-reservation activity of Indian tribes. The Tribe contended that the Kansas tax impacts its ability to impose a tribal tax because the tribal retailer will pass the tax along to reservation customers. It, therefore, urged that the case be decided in light of decisions involving non-Indians doing on-reservation business with a tribe. The Supreme Court looked closely at the issue of the legal incidence of the tax.³⁵ The Court upheld the Kansas position. It viewed the transaction being taxed as one off-reservation and involving non-Indians, the distributor and the motor fuels vendor. It ruled that the legal incidence of the tax falls on the off-reservation, non-Indian distributor. It did so on the basis of the statute's explicitly: (1) lodging the legal incidence of the tax and liability for payment of the tax on the distributor and (2) making receipt of the motor fuels in the state the sole taxable event.³⁶ Although the Court noted that the tax was being

³⁰ 450 U.S. 544 (1981).

³¹ *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982).

³² 448 U.S. 136 (1980).

³³ 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

³⁴ 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 school for a tribe on-reservation.

³⁵ According to the Court's 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." 515 U.S. 450, 459 (1995).

³⁶ The United States had argued that the Kansas Supreme Court, in *Kaul v. Kansas Department of Revenue*, 266 Kan. 464: 970 P. 2d 60 (Kan. 1998), *cert. denied*, 528 U.S. 812 (1999), had found that the legal incidence of the tax on the Indian retailers. The Supreme Court, however, did not accept that interpretation of the case because the language in *Kaul* was ambiguous and

passed along to the customers of the tribal retail operation who were, in the main, recipients of state services, it did not apply the interest-balancing test of *Bracker*. It read *Bracker* and the line of cases applying a balancing test as limited to transactions occurring on-reservation.³⁷ Some language in the decision indicates that, in reaching its decision, the Court was cognizant of the geographical limit of tribal sovereignty and was concerned that a balancing test operates to hamper legitimate goals of tax administration.³⁸ The Court rejected the Tribe's claim that application of the state tax would decrease its revenue, "whether those revenues are labeled 'profits' or 'tax proceeds,'"³⁹ by characterizing such a loss of revenue as the inevitable economic result of any tax that is passed along downstream.

Legislation. Efforts in several recent Congresses to enact legislation to compel tribes to remit state sales taxes on retail sales to non-Indians⁴⁰ have not succeeded; nor has any such legislation been introduced in this Congress to date.

³⁶ (...continued)

the case involved an earlier version of the statute.

³⁷ The Court cited the following cases, which used the *Bracker* interest-balancing test for its conclusion that *Bracker* had only been applied to taxable events occurring on-reservation: *Arizona Dept. Of Revenue v. Blaze Constr. Co.*, 526 U.S. 32 (1999); *Department of Taxation and Finance of N.Y. v. Milhelm Attea & Bros.*, 512 U.S. 61 (1994); *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989); *Ramah Navajo School Bd., Inc. v. Bureau of Revenue of New Mexico* 458 U.S. 832 (1982); and *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134 (1980).

³⁸ "The application of the interest-balancing test to the Kansas motor fuel tax is not only inconsistent with the special geographic sovereignty concerns that gave rise to that test, but also with our efforts to establish 'bright-line standard[s]' in the context of tax administration." *Wagnon* (slip op. 16), quoting *Arizona Department of Revenue v. Blaze Constr. Co.*, 526 U.S. 32, 37 (1999).

³⁹ *Wagnon*, slip op., at 17.

⁴⁰ 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).