Indian Country Tax Update

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A. Business Taxes

***Ute Mountain Ute Tribe v. Rodriguez*, 660 F.3d 1177, 1185 (10th Cir. 2011) cert. denied, 132 S. Ct. 1557, 182 L. Ed. 2d 167 (U.S. 2012)**

The Ute Tribe challenged the same five New Mexico taxes that were at issue in the U.S. Supreme Court's decision *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 109 S.Ct. 1698, 104 L.Ed.2d 209 (1989). A well-reasoned district court decision had applied the *Bracker* balancing test and found that state taxes were preempted on the non-Indian oil and gas operators extracting those resources from the Ute Reservation. The 10th Circuit, applying the same test, disagreed. The court held that because (1) the federal regulatory scheme did not specifically prohibit such taxes; (2) the economic burden on the tribe existed but was not a "proper justification for finding that the taxes are preempted;" and (3) the state provided "off-reservation infrastructure used to transport the oil and gas after it is severed," the taxes were not preempted. Factor (3) is the most problematic. As the district court had held, based on the U.S. Supreme Court's decision *Ramah Navajo Sch. Bd., Inc. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 102 S. Ct. 3394, 73 L. Ed. 2d 1174 (1982), there is no reason to take off-reservation impacts into account because the state is compensated for such burdens through taxing off-reservation activity. This approach will swallow the *Bracker* rule because any meaningful tribal economic development requires some off-reservation presence, and therefore off-reservation infrastructure.

***Mashantucket Pequot Tribe v. Town of Ledyard*, 2012 WL 1069342 (D. Conn. Mar. 27, 2012)**

Earlier this year, a U.S. district court struck down Connecticut and a Town's attempt to tax slot machines owned by non-Indian entities and leased to the Mashantucket Pequot Tribe. The court agreed with the tribe that (1) the tax is preempted by the Indian Trader Statutes, 25 U.S.C. §§ 261–264, (2) the Indian Gaming Regulatory Act ("IGRA"), and (3) pursuant to the balancing test articulated in *Bracker*. In these types of cases, *Bracker* has some remaining vitality. But two aspects are worth noting: first, preemption by IGRA has been viewed previously as *Bracker* preemption. Here, the court treated them as separate inquiries. Second, several decisions have determined that the Indian Trader Statutes do not preempt state taxes in the tobacco context; it may yet be useful outside of that arena. Still this is a common sense application of the Bracker analysis, which should apply if at all in the property context.

***Blue Lake Rancheria v. United States*, 653 F.3d 1112 (2011)**

The Ninth Circuit held last year that Tribal businesses do not have to pay Federal Unemployment (FUTA) taxes where services are performed "in the employ of an Indian tribe" – but only where a tribe or its instrumentality is a "common-law" employer of the worker performing the services.

In *Blue Lake Rancheria v. United States*, the Ninth Circuit held that a because the Tribe's employee leasing and temporary staffing business was a common-law, as opposed to statutory employer, the IRS had incorrectly failed to refund FUTA taxes paid to the tune of about $2 million plus interest. A common-law employer is an employer based on the law of agency, while a statutory employee for purposes of FUTA can simply be a paymaster. Although Blue Lake Rancheria had argued that even services provided by statutory employees were excepted from FUTA, it ended up not mattering to the Ninth Circuit, which found that the tribe's business was in fact a common-law employer.

Tribes in the business of providing leased employees to other business, should carefully navigate the requirements of the *Blue Lake* decision to ensure that they take advantage of what are now clear federal tax benefits.

B. Tobacco Cases

***State v. Comenout*, 173 Wash. 2d 235, 236, 267 P.3d 355, 356 (2011) cert. denied, 132 S. Ct. 2402, 182 L. Ed. 2d 1023 (U.S. 2012)**

In *Comenout* the Washington Supreme Court ruled that, first, the state had jurisdiction over unstamped cigarette sales at store owned by three non-Puyallup tribal members on off-reservation trust land belonging to one member in Puyallup. The Court held that PL 280 gave the state jurisdiction over non-reservation trust land. This result was required from *State v. Cooper*, 130 Wash.2d 770, 928 P.2d 406 (1996), in which the Washington Supreme Court upheld a conviction of a tribal member for an off-reservation trust land crime. The Court's recent decision in *State v. Sohappy*, 110 Wash.2d 907, 757 P.2d 509 (1988), which held that an in lieu site was "reservation" for purposes of PL 280, is not to the contrary. Second, the Court rejected the Comenouts' argument that they were "Indian retailers" and therefore state taxes were preempted by a tax compact with the Quinault Tribe because the store was not licensed by that tribe. Had it been, conceivably the store would have been excepted from state taxes under the state law (while subject to tribal regulation).

***United States v. Morrison*, 686 F.3d 94, 96 (2d Cir. 2012)**

A RICO defendant argued that his conviction under the CCTA was improper because that statute requires that the state in which the allegedly contraband cigarettes are found must "require" tax stamps to be placed on cigarettes. Morrison argued that because New York was refraining from enforcing taxes on on-reservation sales at the time of the conduct at issue, tax stamps were not "required." The Second Circuit rejected his argument, noting that the state's forbearance policy "represented New York's beleaguered concession to the difficulty and danger of state-level enforcement, the complex jurisdictional issues surrounding reservation-based cigarette sales, and the politically combustible nature of bootlegging prosecutions." But did not evince a lack of requirement for tax stamps.

***United States v. Wilbur*, 674 F.3d 1160 (9th Cir. 2012)**

In *Wilbur*, the Ninth Circuit held that cigarettes sold by a tribally licensed retailer and pursuant to a state-tribe cigarette agreement are not contraband for purposes of the federal Contraband Cigarette Trafficking Act (CCTA) – even if they are contraband under state law.

According to the Appeals Court, even if cigarettes are transported in violation of state law, the CCTA only makes cigarettes "contraband" in this context if they "bear no evidence of the payment of applicable State or local cigarette taxes in the State or locality where such cigarettes are found." 18 U.S.C. § 2341(2). The cigarettes at issue during one period of the *Wilbur* case were unstamped. But the defendants qualified as an Indian retailer under Washington state law, came partially within the constraints of a tribal tobacco tax compact, and therefore were not subject to state taxes – even though they were allegedly illegal under state cigarette transportation laws and were out of compliance with some tribal regulations.

At its core, for the period in which convictions were overturned, the decision implicitly recognized the legitimacy of tribal tobacco regulation. This could, by analogy or otherwise, undercut the interpretation of the Prevent All Cigarette Trafficking (PACT) Act by federal agencies that suggested tribal tobacco entities must be licensed by the state to be considered "lawfully operating" under that federal law.

The Wilbur defendants' convictions were upheld for other periods of the alleged conspiracy. And of more concern is the appearance of state officers acting in federal clothing. As the opinion observed, "a Lieutenant with the Washington State Liquor Control Board who was deputized as a Special Deputy U.S. Marshall, led the search" of the defendants' retail facility. Although tribal law enforcement also participated in the raids, it is nonetheless noteworthy that reliance by federal statute on state law predicates is problematic in the face of "the right of reservation Indians to make their own laws and be ruled by them." *Williams v. Lee*, 358 U.S. 217, 220 (1959).

The apparent ability for state officers to don federal clothing and enforce the state-federal hybrid criminal frameworks on reservations is an even more profound threat to that right. As explicitly contemplated by the Tribal Law and Order Act, if federally deputized non-federal officers are enforcing laws on the Reservation, it should be federally deputized

tribal officers doing so. This concern is of course nothing new, as Indian Country recently resisted the STOP Act, which would have imported state and big-tobacco interests into Reservation economies under color of federal law, including by way of state cops masked as federal officers. Wolves in sheep's clothing; Trojan horse; pick your cliché. This is a trend to watch, and guard against.

Besides the clarity provided by *Wilbur*, and its limitation on the reach of the CCTA, in the end, a state was still able to enforce its laws on the Reservation, against Reservation Indians.

***Muscogee (Creek) Nation v. Pruitt*, 669 F.3d 1159, 1165 (10th Cir. 2012)**

The Tenth Circuit rejected Muscogee's contentions that state cigarette taxes on sales to non-Indians (1) are preempted by the Indian Trader Statutes, and (2) violate the tribe's right to tribal self-government. The first question was resolved in this context by the U.S. Supreme Court in 1994 in *Dep't of Taxation & Fin. of New York v. Milhelm Attea & Bros., Inc.*, 512 U.S. 61, 114 S. Ct. 2028, 129 L. Ed. 2d 52 (1994). According to the court, the second question has been resolved repeatedly by every U.S. Supreme Court case examining whether state taxes on non-Indian cigarette buyers are legal. Critically, the court noted that state cigarette laws like its MSA Escrow Statute regulate tobacco product manufacturers. "Neither [the tribe] nor any of its businesses manufacture such products. The State enforces these laws by seizing cigarettes outside Indian country."

***Red Earth LLC v. United States*, 657 F.3d 138 (2d Cir. 2011)**

The Second Circuit Court of Appeals held late last year that provisions of the Prevent All Cigarette Trafficking ("PACT") Act are likely unconstitutional and upheld an injunction halting enforcement of the new law. The Second Circuit's decision in *Red Earth v. USA* signals federal courts' willingness to scrutinize the federal governments' scorched-earth approach to tribal tobacco economies. Critically, it was not a tribal tax rule that halted enforcement, but rather the most basic tenet of Constitutional law: due process. Putting it even more simply, the PACT Act wasn't fair.

Red Earth d/b/a Seneca Smokeshop ("Red Earth"), a tribal-member owned tobacco retailer on Seneca's Cattaraugus Indian Reservation in New York, prevailed against the United States at the trial court level earlier this year. The U.S. District Court for the Western District of New York held in July that the PACT Act's provision requiring out-of-state tobacco sellers to pay state excise taxes regardless of their contact with that state violated due process. The court explained clearly, and not controversially, that due process requires an out-of-state seller to maintain minimum contacts with a state before the state can subject it to taxation. This isn't even basic Indian tax law, but basic tax law – even basic Constitutional law. The district court found that the PACT Act's mandate that delivery sellers pay state taxes without regard to their contact with that state effectively "legislate[d] the due process requirement out of the equation." *Red Earth LLC v. United States*, 728 F. Supp. 2d 238, 252 (W.D.N.Y. 2010). The Second Circuit

agreed, noting that Congress does not have the power to authorize violations of the Due Process Clause of the U.S. Constitution.

***City of New York v. Milhelm Attea & Bros., Inc.*, 06-CV-3620 CBA, 2012 WL 3579568 (E.D.N.Y. Aug. 17, 2012)**

The New York Cigarette wars continued with a district court ruling in August that the New York City could proceed with civil CCTA claims against non-Indian suppliers of cigarettes to New York Indian reservations. In what will be known as *Milhelm IV*, the court rejected each of the main suppliers' arguments for why they were not "require[d]" to place state tax stamps" on "vast quantities of unstamped cigarettes to reservation retailers since prior to this litigation", among them that state law did not require stamps (it did, as decided in *Morrison, supra*), liability was barred because they told the state how much tobacco was sold (it wasn't); lack of knowledge/intent due to ambiguity and the city's forbearance (under CCTA you must only know that you possess unstamped cigarettes).

***U.S. v. Nappi*, 09CR51A, 2012 WL 4857583 (W.D.N.Y. Sept. 20, 2012) report and recommendation adopted, 09-CR-51A, 2012 WL 4857582 (W.D.N.Y. Oct. 11, 2012)**

The defendant in *Nappi* argued that in light of the legislative and judicial history regarding the validity of New York's tobacco tax, he was "insufficiently warned," and thus, could not be held criminally liable for "failing to recognize that he was prohibited from selling unstamped cigarettes on Native American reservations to non-Native Americans during the time period covered by the indictment." Relying on *Morrison II*, *supra*, the court rejected this argument, saying, basically, you should have known, despite forbearance, that you couldn't sell untaxed cigarettes to non-Indians. This is the obvious result after Morrison II, but critically the court interpreted that case as standing for the proposition that "the CCTA was designed to provide federal support to the states in enforcing their tax laws." This is exactly what is wrong with the CCTA. *Williams v. Lee,* 358 U.S. 217 (1959).

***Miller v. Wright*, 3:11-CV-05395 RBL, 2011 WL 4712245 (W.D. Wash. Oct. 6, 2011)**

The ongoing dispute between an enrolled Puyallup tribal member and his Tribe over cigarette regulation and the taxation scheme on the reservation flared up again late last year. In this round of the *Matheson* dispute, the member, whose store sold cigarettes, sued the Tribe, Tribal chairman, and CEO of the Tribe's economic development corporation for alleged price-fixing, antitrust, and unfair competition by imposing taxes on all purchases of cigarettes within the boundaries of the Puyallup Indian Reservation. The court dismissed the lawsuit based on sovereign immunity and res judicata, and barred discovery, noting: "Until a court resolves the question of sovereign immunity, discovery should not proceed."

C. Other Cases

***Fond du Lac Band of Lake Superior Chippewa v. Frans*, 649 F.3d 849, 850 (8th Cir. 2011)**

Last year the Eighth Circuit Court of Appeals upheld Minnesota's tax on the retirement income of Charles Diver, a Chippewa who the United States relocated to Ohio in 1960. He worked there as a dockworker until 1998, when he retired and returned home to the Fond du lac Reservation. The court allowed Minnesota to tax the pension that Diver earned in Ohio and now receives on the reservation, even though "Minnesota could not have taxed his wages as he received them because the state did not have the required nexus." He never worked in Minnesota.

***Smith v. C.I.R.*, 101 T.C.M. (CCH) 1368 (T.C. 2011)**

Nooksack tribal councilpersons claimed that all of their income as councilmembers was exempt because it all related to treaty fishing, and was therefore subject to Section 7873, which exempts "income derived by a member of an Indian tribe from a fishing rights-related activity."

The trial court record was unclear, so the Tax Court, and the IRS, used the percentages of the tribe's budget spent on fishing to calculate the amount of compensation derived from treaty fishing activities – between 10 and 12 percent over the years 2003-2005. Critically, the Tax Court adopted the reasoning that Tribal Council activity related to fishing was subject to Section 7873. Moreover, the calculation could have been widely off the mark since Tribal Council could have spent all or none of their time on fishing, and only budgeted that 10-12 percent.

***Auto. United Trades Org. v. State*, 285 P.3d 52 (Wash. 2012)**

The Washington State Supreme Court held 5-4 in August that the Washington Automotive United Trades Organization (AUTO) lawsuit attacking Tribe-State Fuel Tax Agreements can move forward.

The majority found that Tribes are not indispensable parties to the lawsuit. At the core of its lawsuit, AUTO argues that the state, Governor Christine Gregoire, and the state Department of Licensing are violating the Washington Constitution by entering into the fuel compacts with Tribes and that the legislative system surrounding the compacts itself is illegal.

The Court held the tribes were not indispensible based on four required factors. Analyzing the first factor, prejudice to the tribes, the Court held that the tribes would be severely prejudiced. As the majority noted, "[t]his first factor strongly favors dismissal." Usually, with immune parties, this is the end of the discussion. This has certainly been the historic approach of Washington Courts.

The second factor is whether the Court can fashion relief to reduce such prejudice. The Court recognized that because AUTO's solution – suing tribal officials who signed the

fuel tax agreements – was as bad as the prejudice, "the second CR 19(b) factor favors dismissal." The Court did not even really apply the third factor (adequacy of judgment without the tribes) but found that it counseled for dismissal anyway. Relying then completely on the fourth factor, the absence of remedy upon dismissal, the Court held that because "there appears to be no other judicial forum in which plaintiffs can seek relief, the plaintiff lacks an adequate remedy in the event of dismissal," the case could not be dismissed.

***Miccosukee Tribe of Indians of Florida v. United States*, 11-CV-23107, 2012 WL 2872166 (S.D. Fla. July 12, 2012)**

In case it was not clear before, tribes face an uphill battle in quashing IRS summonses. The Miccosukees challenged IRS investigations again based on sovereign immunity and failed. Using IRS common law, the tribe also argued that the summons were improper otherwise. The district court dismissed such concerns, though with much more care than it paid to the somewhat hail-mary sovereign immunity attempt.

***Oneida Indian Nation of New York v. Madison County*, 665 F.3d 408, 414 (2d Cir. 2011)**

This is the U.S. Supreme Court's remand to the Second Circuit of the long-standing dispute over Oneida fee land. To avoid the high court's hearing of the question of whether sovereign immunity barred the county from foreclosing on the tribe's land, the tribe, wisely, waived its sovereign immunity. On remand, this put the tribe in the awkward position of arguing that had waived immunity and the county arguing that there were still questions as to the efficacy of the waiver.

***Cayuga Indian Nation of New York v. Seneca County, N.Y.*, 11-CV-6004 CJS, 2012 WL 3597761 (W.D.N.Y. Aug. 20, 2012)**

It's déjà vu all over again in upstate New York, where an district court has resurrected the best portions of *Oneida* from the cutting room floor.

The district court rejected the county's argument that *County of Yakima v. Confederated Tribes and Bands of the Yakima Indian Nation*, 502 U.S. 251 (1992) allowed in rem property tax foreclosure proceedings in the face of tribal sovereign immunity, noting:

> Even assuming that Seneca County has the right to impose property taxes on the subject parcels owned by the Cayuga Indian Nation, it does not have the right to collect those taxes by suing to foreclose on the properties, unless Congress authorizes it to do so, or unless the Cayuga Indian Nation waives its sovereign immunity from suit. Congress has not authorized Seneca County to sue the Cayugas, and the Cayugas have not waived their sovereign immunity. Consequently, the Cayugas' motion for an order enjoining the foreclosure actions must be granted.

Counties should continue to be barred from judicial foreclosure proceedings over tribal property through the exercise of sovereign immunity.

***Oneida Tribe of Indians of Wisconsin v. Vill. of Hobart, Wis.,* 10-C-137, 2012 WL 3839570 (E.D. Wis. Sept. 5, 2012)**

This is the latest battle in the war between the Oneida Tribe of Indians of Wisconsin and the Village of Hobart over the regulatory control of tribal lands. In this round, the federal court for the Eastern District of Wisconsin Village's Storm Water Utility Management charges were an impermissible tax on Tribal trust property for which neither the Tribe nor the United States are liable. When a court's first cite is to the chestnut *The Kansas Indians*, 5 Wall. 737, 72 U.S. 737, 18 L.Ed. 667 (1866), it's a good sign. The village argued that the stormwater charges were fees, not taxes. And they might be under state law. But the court applied federal law, because the tribe's rights were "federal" in nature. Because (1) the legislative body imposed the fee; (2) the public at large is assessed (3) and the revenue generated by the fee is expended for general public purposes, the charges were taxes under federal law.

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