The Power to Tax Economic Activity in Indian Country

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As Chief Justice John Marshall wrote nearly two centuries ago, "the power to tax involves the power to destroy." *McCulloch v. Maryland*, 17 U.S. 316, 431 (1819). In *McCulloch*, the Court held that a state tax on an instrumentality created by Congress was unconstitutional. Not long after *McCulloch*, the Supreme Court invalidated the application of a Georgia law that prohibited "white persons" from living in Cherokee territory without a state-issued license. *Worcester v. Georgia*, 31 U.S. 515 (1832), *see* Cohen's Handbook of Federal Indian Law § 1.03[4][a] (2012 ed.). Two missionaries residing in the Cherokee Nation had appealed their convictions and imprisonment by the state. Explaining that the Constitution conferred exclusive power to Congress for the regulation of commerce with the sovereign tribes and provided the executive branch with authority for treaty-making with the tribes, the Chief Justice wrote, "The whole intercourse between the United States and this nation is, by our Constitution and laws, vested in the Government of the United States." 31 U.S. at 561. In light of the supremacy of federal law, the Court held that the Cherokee Nation is "a distinct community, occupying its own territory . . . in which the laws of Georgia can have no force, and which the citizens of Georgia have no right to enter but with the assent of the Cherokees themselves, or in conformity with treaties and with the acts of Congress." *Id.*

Worcester remains one of the most frequently cited Supreme Court cases from the era prior to the Civil War, with its conclusion that Indian tribes retain their preconstitutional powers of self-governance over their members and their territory, subject to the superior power of the federal government, and the regulation of relations with the tribes is "committed exclusively to the government of the Union." *Id.* The modern Supreme Court's references to *Worcester*, however, are but faint echoes of Chief Justice Marshall's unequivocal federal preemption of state law on Indian lands. Today, the Constitution's allocation of power to Congress to regulate Indian commerce no longer categorically bars state regulation or taxation in tribal territory. States, and their governmental subdivisions, are still categorically barred from taxing tribes and tribal members within Indian country. *E.g., Okla. Tax Comm'n v. Sac & Fox Nation*, 508 U.S. 114, 123 (1993); *see generally* Cohen's Handbook § 8.03[1][b]. With respect to non-Indians, though, the Court has applied a "flexible preemption analysis." *Cotton Petroleum v. New Mexico*, 490 U.S. 163, 176 (1989).

The Court's flexible preemption approach involves a balancing test that weighs federal and tribal interests against those of the state. Instead of ousting state authority from Indian lands, since the 1970s, the Court has found itself "often confront[ing] the difficult problem of *reconciling* the plenary power of the States over residents within their borders with the semi-autonomous status of Indians living on tribal reservations." *Ramah Navajo Sch. Bd., Inc. v. Bureau of Revenue of N.M.*, 458 U.S. 832, 836–37 (1982) (emphasis added and internal quotations omitted) (quoting *McClanahan v. Ariz. State Tax Comm'n*, 411 U.S. 164, 165 (1973)). Through the application of this approach, state and local governments have been allowed to regulate and tax a tribe's on-reservation economic activity when the tribe engages in commerce with non-Indians. This article explores some of the ways in which the Supreme Court's recent decisions involving taxation in Indian country have undermined the policies of Congress and the executive branch.

For most of the last half century, federal policy has supported tribal self-determination and self-government. This policy has been expressed in numerous acts of Congress and in a great many actions taken by the executive branch. *See generally* Cohen's Handbook § 1.07 (2012 ed.). Over the course of American history, however, support for tribal self-government has been anything but constant. Rather, federal Indian policy has oscillated between supporting tribal self-government and forcing Indian people to become assimilated into the American mainstream. As President Obama recently noted, "through generations of struggle, American Indians and Alaska Natives held fast to their traditions . . . and eventually the United States Government . . . began to turn the page on a troubled past." Proclamation No. 9054, 78 FR 66619 (Nov. 5, 2013).

During the self-determination era, new stories of tribal recovery and nation building have begun to emerge. Tribes are consolidating land-holdings, reinvigorating their cultures, and revitalizing their sovereign governance systems. But the "troubled past" still causes problems. The endemic poverty that exists in much of Indian country has many causes, some of which are intertwined with the historic trauma of dispossession from their homelands and forced assimilation. From the moment Columbus saw gold shining in the earlobes of Arawak Indians, Europeans, amazed by the abundance of the new world, sought to take its bounty regardless of its impact on indigenous Americans. The story line has been repeated over time and in different regions. Lands relied upon by indigenous Americans to sustain their ways of life contained resources coveted by settlers, speculators and industry. Many tribes were pushed off their territories. Others ceded most of their territory in exchange for promises that the government would provide for their health, education, and welfare and would also protect their right to continue to live as self-governing peoples within the lands they had reserved for themselves.

Most Americans have some generalized awareness of the

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kinds of historical traumas that tribal nations have endured. There seems to be much less awareness that, after the establishment of Indian reservations, there were two historical eras during which the objective of federal policy was assimilation: the allotment era (1871–1928) and the termination era (1943–1961). *See generally* Cohen's Handbook at §§ 1.04, 1.06. There are legacies from those two eras that continue to present challenges for many tribal nations. The legacies of those two eras continue to influence the ways that the Supreme Court weighs the interests of states in tax matters within Indian country.

In contemporary United States, tribal governments deliver a range of services, some of which were historically provided by the Bureau of Indian Affairs and the Indian Health Service. Such services are typically supported with funding through contracts or compacts pursuant to the Indian Self-Determination and Education Assistance Act of 1975, as amended. 25 U.S.C. § 450 *et seq.* But tribes also need nonfederal sources of revenue. For many tribes, gaming has provided a source of nonfederal revenue. Another option, the standard option for most nonfederal units of government, is to develop a tax base. Having a tax base is a prerequisite for a strategy that many governments use to stimulate economic development—offering targeted tax incentives. With states and local governments taxing on-reservation transactions, however, tribes lose the opportunity to generate revenues that would benefit their communities. Tribes must reduce their tax rates or forgo taxes entirely. Even then, the threat of double taxation still scares off investors. Tribal tax incentives are out of the question.

Tribal governments need to be able to stimulate economic development. Residents of Indian reservations are some of the most impoverished peoples in the United States. In fact, 23 percent of Native American families living within or near tribal areas have earned incomes below the poverty line. U.S. Department of the Interior, 2013 American Indian Population and Labor Force Report 11 (2014). The DOI report did not estimate "unemployment" rates, because, as defined by the Department of Labor, people who are not actively looking for a job are not counted, and, with employment opportunities in Indian country in short supply, many people are assumed to not be actively looking. The DOI report did estimate that "about 49–50 percent of all Native Americans in or near tribal areas who are 16 years or older, *are* employed either full or part time." *Id.* at 10. This means that, of the potential Indian labor force in Indian country, *about half the people are not employed.* Many tribal nations are naturally resource rich or well-situated for renewable resource development, yet reservation economies are typically fragile, with their infrastructure under-developed and their citizens underserved. What tribes need is more certainty in the preemption of state power and less flexibility.

Preemption of State Taxes in Federal Indian Law

Preemption analysis has been employed by the Court in deciding a number of conflicts pitting tribal sovereignty and federal policy against states' interests in taxing tribal natural resource development. A leading case involved Arizona's attempt to tax a non-Indian company doing business with the White Mountain Apache Tribe's timber enterprise. *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980). In *Bracker*, the Court explained two "independent but interrelated" barriers to state regulatory authority over tribal reservations: (1) state authority may be preempted by federal law; and (2) state law may unlawfully infringe on the "right of reservation Indians to make their own laws and be ruled by them." *Id.* at 142. These grounds are independent in that either can be sufficient for striking down a state law; they are interrelated in that the right of tribal self-government informs the interpretation of federal laws that may operate to preempt state law.

***Worcester* remains one of the most frequently cited cases for its conclusion that Indian tribes retain their preconstitutional powers of self-governance over their members and their territory.**

The Court commented that it is "generally unhelpful" to apply to Indian cases standards for federal preemption that "have emerged in other areas of the law." *Id.* at 143. In such other areas of the law, standards for federal preemption have emerged in cases when Congress legislates "in a field which the States have historically occupied." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Relations with Indian tribes is not such a field, but rather is among the enumerated powers of the federal government. Thus, in the Indian law variant of the analysis, federal preemption is often found without any explicit statement by Congress to indicate such intent. *Bracker* at 151.

After acknowledging that the Court had departed from Chief Justice Marshall's view that state law can have no force within an Indian reservation, the *Bracker* Court said that, when "a State asserts authority over the conduct of non-Indians engaging in activity on the reservation," determining whether the exercise of state authority would violate federal law requires a "particularized examination of the relevant state, federal, and tribal interests." *Id.* at 144–45. The uncertainty surrounding this "particularized inquiry" is evidenced by the Court's recurring involvement in balancing interests in cases examining a variety of state taxes imposed upon many forms of commerce in Indian Country.

In an interest balancing case not long after *Bracker*, the Court ruled that a state tax that imposed an indirect economic burden on a tribe was preempted. In *Ramah Navajo School Board v. Bureau of Revenue*, 458 U.S. 832 (1982), the Court found that although New Mexico's tax of private construction companies for activities on the Navajo reservation placed the legal incidence of the tax on the non-Indian construction contractors the Court held the tax preempted as "the economic burden of the asserted taxes would ultimately fall on the Tribe" because the tribe had agreed to reimburse contractors for the tax. *Id.* at 853–54 (quoting *White Mountain Apache Tribe v.*

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Bracker, 448 U.S. 136, 151 (1980)). In a similar vein, the Court summarily affirmed a Ninth Circuit ruling preempting a Montana coal tax found to interfere with the self-government rights of the tribe because the tax was so high as to limit the marketability of that coal. The Court affirmed the appeals court's determination that federal policies protected tribes from state taxes that appropriated the value of Indian natural resources and imposed a "substantial burden" on the tribe. *Montana v. Crow Tribe*, 484 U.S. 997 (1988), *affirming* 819 F.2d 895 (9th Cir. 1987).

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The right of tribal self-government is always a factor in the interest balancing analysis, or, as the *Bracker* Court put it, "an important 'backdrop' . . . against which vague or ambiguous federal enactments must always be measured." *Bracker* at 143. The Court has upheld the tribes' authority to impose their own tribal taxes on non-Indian businesses in Indian Country as an aspect of self-government. In *Merrion v. Jicarilla Apache Tribe*, the Court found the tribe's tax power to be "an essential attribute of Indian sovereignty because it is a necessary instrument of self-government and territorial management." 455 U.S. 130, 137 (1982). The Court recognized the tribe's tax as the exercise of an inherent power of tribal governments that "derives from the tribe's general authority, as sovereign, to control economic activity within its jurisdiction, and to defray the cost of providing governmental services [by requiring those acting within the territory to contribute]." *Id.*

The ability of tribes to utilize their sovereign tax authority to generate revenue and stimulate economic activity, however, was stifled by the Supreme Court's ruling in the sequel to *Merrion*. Cotton Petroleum, one of the oil companies that had challenged the Jicarilla Apache Tribe's severance tax in *Merrion*, returned to the Supreme Court and argued that since the tribal tax was permitted to stand, federal law must preempt the State of New Mexico's tax on those same oil extraction activities. *Cotton Petroleum v. New Mexico*, 490 U.S. 163 (1989). The Tribe was not a party to *Cotton Petroleum* but argued in its amicus brief that the state's tax should be preempted as it interfered with the tribe's right of self-government because of the substantial economic burden of the tax on the tribe.

Justice Stevens, who had dissented in *Merrion*, contesting the conclusion that tribal sovereignty includes the power of taxation over nonmembers of the tribe, authored the majority opinion in *Cotton Petroleum*. Justice Stevens wrote that although a state cannot tax the United States directly (and, correspondingly, cannot tax reservation lands held in trust by the United States for tribes), the state may tax the private parties with whom an Indian tribe does business, even though the financial burden of those taxes may fall on the tribe.

The Problem of Dual Taxation

In *Cotton Petroleum*, the Court pointed out that Congress could render the state tax inapplicable to tribal trust lands, either by express statutory language or by plain implication. The Court held that in this case Congress had not done so. Unless and until Congress exercises that power, the Court concluded, each of the two sovereigns has taxing jurisdiction over all of the non-Indian companies' leases. In a legal vacuum, the Court's authorization of both sovereigns to tax might be interpreted as striking a fair balance. Commercial reality, however, renders the tribal tax economically infeasible.

Dual taxation interferes with the ability of tribes to develop tax bases. Although tribes have authority to tax nonmembers doing business in Indian Country, when other jurisdictions can tax those same nonmembers for the same transactions, tribes must lower their taxes to keep overall pricing at rates the market can bear or forgo levying a tax at all. Dual taxation limits the tribes' ability to offer tax incentives to stimulate economic activity. With state taxation applicable to non-Indians, even offering complete tribal tax immunity would not yield a tax rate any lower than the existing state tax that is applicable off reservation. Congress has sought to compensate tribal governments for this adverse impact through various tax credits to non-Indians that locate businesses on-reservation, but these have been underutilized due to complex qualification rules, their short-term duration, and their modest economic benefit. *See* Porter, Robert O. Testimony to the U.S. Senate Committee on Finance, Hearing on Tax Reform: What It Could Mean for Tribes and Territories. Hearing, May 15, 2012 (S. Hrg. 112-772) (discussing deficiencies associated with investment tax credits, accelerated depreciation for qualified Indian reservation property, Indian employment tax credits, renewal communities and work opportunity tax credits).

There is a fundamental inequity in dual taxation that may not be readily apparent. A state tax on transactions taking place in Indian country affects pricing in Indian territories to the same extent as a tribal tax, but, in setting its tax rates, the state need not be concerned about whether its tax policy fosters outcomes beneficial to those who reside within that jurisdiction. Thus, when a state tax is set so high as to cause a reservation product's price to increase and demand for that product to decline, the only harm to the state associated with that resource's decline in on-reservation production is the reduced tax revenue the state receives from that particular revenue source, which is likely to be only a very small portion of the state's overall tax revenue. That same state tax's negative impact on the demand for a tribal resource, however, may have dramatic consequences for the tribe. Not only would the tribe lose tax revenue and royalty revenue associated with the decline in production (which may be a very substantial portion of the tribe's overall revenue), but also the decline in production could result in layoffs of tribal workers, straining already overextended tribal social welfare services.

Congress could fashion a fix for dual taxation, but it has not

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yet done so. Such a fix might include a finding that supporting tribal self-determination requires preempting state taxation of natural resources development on Indian lands. Such a fix would not be without precedent. Congress has granted immunities from state tax in specific contexts, such as Indian gaming. The Indian Gaming Regulatory Act (IGRA) expressly forbids state and local taxation of the gaming activities tribes conduct on their Indian lands. 25 U.S.C. § 2710(d)(4). IGRA permits payments by tribes to states and local governments solely through negotiated compact terms designed to compensate other governments for the direct costs of the services they provide to the tribe's gaming facilities. In 1992, not long after *Cotton Petroleum*, Congress did authorize a Commission to develop recommendations on dual taxation and to report to Congress. Pub. L. No. 102-486, § 2605 (formerly codified at 25 U.S.C. § 3505). That Commission, however, was never established, and the statutory authorization was repealed by Title V of the Energy Policy Act of 2005. 25 U.S.C. § 3501 *et seq*.

Flexible Preemption in the Lower Federal Courts

In the absence of direction from Congress, the federal courts have been called upon to resolve jurisdictional disputes applying the flexible preemption doctrine. In one case, the Tenth Circuit held that a state motor fuels tax was preempted by a tribal tax only to have the Supreme Court rule that the Tenth Circuit had erred in even applying preemption analysis with its interest balancing test. *Prairie Band Potawatomi Nation v. Richards*, 379 F.3d 979 (10th Cir. 2004), *reversed sub nom Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95 (2005). The Supreme Court's ruling turned on its finding that the state tax was imposed on transactions occurring off the reservation.

The rulings of the lower courts have become increasingly elaborate and ultimately inconclusive. Their difficulty applying the Court's flexible preemption analysis is illustrated in the Ute Mountain Ute Tribe's litigation with New Mexico over the state's attempt to tax oil and gas production on the tribe's reservation.

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The Ute Tribe sued New Mexico in federal district court alleging the state had no authority to collect taxes on oil and gas extracted from the reservation. It argued that the state tax imposed an undue economic burden on the tribe that infringed tribal sovereignty and that the tax could not be justified because the state provides no services or benefits to the tribe and its members on the reservation. The district court found the balance of interests to favor the tribe, particularly because the state tax hindered the tribe's ability to impose its own severance tax and impeded the tribe's ability to attract new oil and gas leases. *Ute Mountain Ute Tribe v. Homans*, 775 F. Supp. 2d 1259 (D.N.M. 2009).

The Tenth Circuit reversed. *Ute Mountain Ute Tribe v. Rodriguez*, 660 F.3d 1177 (10th Cir. 2011). It found error in the district court's concern with the "indirect" economic burden of the state tax on the tribe. The appeals court asserted that the Supreme Court's particularized inquiry under *Cotton Petroleum* is limited to whether the state tax caused a direct economic burden on the tribe. The Tenth Circuit also considered that the state's off-reservation infrastructure increased the value of the tribe's oil and gas by facilitating the marketability and value of the tribe's oil and gas. The Tenth Circuit's 2011 ruling reflects not only how far doctrine has evolved since *Worcester's* recognition of a constitutionally required, territorially based preemption, but also how much further the balance leans stateward since the Court decided *Bracker* in 1980.

Administration of the flexible preemption doctrine by the lower courts creates layers of uncertainty even over such questions as when to apply the particularized inquiry. The extent of the involvement of non-Indians, the status of the land, the characterization of the state tax, and the nature of the activity all play a role. Sometimes not doing interest balancing may cut in a tribe's favor. For example, the Ninth Circuit recently struck down local government property taxes on a tourist resort and lodge developed on trust land, and it did so without relying upon the balancing test. Citing Supreme Court precedent that Indian lands held in trust by the United States may not be taxed, Ninth Circuit held that the state and local tax immunity of trust lands extends to permanent improvements on those lands. *Confederated Tribes of the Chehalis Reservation v. Thurston Country Board of Equalization*, 724 F.3d 1153 (9th Cir. 2013) (citing *Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973)).

The Second Circuit did apply the balancing test, however, to find that a local government's personal property tax could be levied on slot machines leased from a non-Indian vendor for use in a tribal gaming facility located on Indian land even though IGRA expressly forbids state and local taxation on the gaming activities of tribes on Indian lands. The appeals court found that since the town's tax was imposed on the ownership of the property and not the use of the property, the tax did not interfere with IGRA's preemption. *Mashantucket Pequot Tribe v. Town of Ledyard*, 722 F.3d 457 (2d Cir. 2013).

Help from the Executive Branch

Federal policy recognizes tribes as sovereigns with authority over land and resources, yet case law impinges their capacities to employ tax policies designed for resource conservation and resource development. Challenges arising from tax uncertainties are not limited to extractive resources but also affect tribes' abilities to develop their renewable energy resources. Many tribes are exploring wind, solar, geothermal and other power generation. Harnessing this energy requires capital-intensive technologies, and partnerships with non-Indian investors call for examination of numerous issues. One key factor is whether a court would treat the installed equipment (e.g., wind turbines) as permanent improvements on the land, and therefore not taxable, or subject to the flexible preemption balancing

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test that would allow state and local government taxation.

The courts cannot be expected not resolve these problems. Congress can fix them, but so far has not done so. The executive branch, however, recently has taken steps to clarify application of the balancing test to transactions that involve leases of Indian land. Bureau of Indian Affairs, Residential, Business, and Wind and Solar Resource Leases on Indian Lands, 77 Fed. Reg. 72440)(Dec. 5, 2012) (codified at 25 C.F.R. pt 162). The revised regulations provide explicit regulatory language regarding nonmember activities on Indian lands, language intended to preempt state and local taxation of improvements on leased Indian land, leasehold or possessory interests, or activities occurring or services performed on leased Indian land. 25 C.F.R. § 162.017. The regulatory language and the discussion in the preamble seek to establish a clear preemption rule by expressly asserting that the strengths of federal and tribal interests regarding the leasing of Indian lands are such that leases executed under the regulations will foreclose state taxation under the balancing test developed in *Bracker*. These regulatory terms seek to set forth the type of bright-line rules that tribal leaders have been seeking with respect to state and location taxation.

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The revised leasing regulations have been the subject of dispute in two cases related to lands of the Agua Caliente Tribe in California. In *Desert Water Agency v. U.S. Department of the Interior*, No. 13-606 (C.D. Cal. Jan. 21, 2014), the water agency argued its fees were not preempted by Section 162.017, on the ground that the phrase, "subject only to applicable Federal law," in that provision is intended to only to clarify that the *Bracker* balancing test applies. In the alternative, if the water agency's fee is preempted by the regulations, the agency called for the regulations to be invalidated as arbitrary and capricious agency action. The district court dismissed the water agency's claims for lack of standing and because there was no controversy ripe for judicial action as Interior had yet to take any action against the water agency. Meanwhile, in *Agua Caliente Band of Cahuilla Indians v. Riverside County*, No. 14-0007 (C.D. Cal. filed Jan. 2, 2014), the tribe has requested declaratory and injunctive relief from the county's levy of a possessory interest tax on lessees of the tribe's trust lands and permanent improvements because that tax violates federal law (including Section 162.017 of the leasing regulations) and infringes on the tribe's sovereignty.

Establishing greater tax certainty will likely depend on legislative action. A number of tribes and intertribal organizations have sought congressional engagement, and several federal tax law proposals to address state taxation have been offered by tribes and tribal organizations to the tax-writing committees. Some of these proposals seek to ensure that the federal tax code treats state and tribal governments similarly when carrying out similar responsibilities in their respective jurisdictions, in a sense, to more comprehensively carry out the basic policy of the Indian Tribal Governmental Tax Status Act of 1983. 26 U.S.C. § 7871. One proposal calls for the establishment of tax-free "Empowerment Zones" modeled on the foreign trade zone concept. In presenting the concept to the Senate Finance Committee, former Seneca Nation President Robert Porter urged Congress to return to the fundamental understandings of the Constitution as articulated in *Worcester*. He called for Congress to advance "the first principles that are at the foundation of federal Indian policy at its best—tribal nations are governments whose exclusive authority to govern all economic activity on their territory is fully respected as a matter of federal law." Porter, Robert O. Testimony to the U.S. Senate Committee on Finance, Hearing on Tax Reform: What It Could Mean for Tribes and Territories. Hearing, May, 15, 2012 (S. Hrg. 112-772). Washington: Government Printing Office, 2012.

In *McCulloch*, Chief Justice Marshall wrote that, in holding the state's tax in prohibited, "We are relieved . . . from clashing sovereignty; from interfering powers . . . from the incompatibility of a right in one Government to destroy what there is a right in another to preserve." 17 U.S. at 156. He added that this also avoids "the perplexing inquiry, so unfit for the judicial department, what degree of taxation is the legitimate use and what degree may amount to the abuse of the power." *Id.*

In the absence of congressional direction, decisions of the Supreme Court have created an elaborate jurisprudence that charges headstrong into "clashing sovereignty" and "interfering powers" to conduct the "perplexing inquiry" that the Court believes will distinguish the legitimate from the abusive taxes. The inquiry John Marshall found "so unfit for the judicial department" has become a pivotal element of the Court's federal Indian law jurisprudence. Its impact on tribal natural resources development, tribal economic development, and job creation has been a focus of scholarship and advocacy but has not obtained widespread awareness or outrage to prompt congressional action.

Until the problem of dual taxation is addressed, the federal government's attempts to foster self-determination are not likely to flourish. Faced with uncertainty as to the cost of doing business on their reservations and lacking the ability to offer tax incentives to stimulate innovation and attract investment, tribes will see many of the fruits of their resource development activities benefit their neighboring jurisdictions. Four decades of experience with the self-determination policy should provide sufficient insight for the Congress to infuse that policy with tools that enable tribes to establish greater governance authority and tax certainty over the resources upon which their tribal economies depend.

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