

"We're Not in Kansas Anymore": *Wagnon v. Prairie Band Potawatomi Nation* and the Quandaries of State Taxation in Indian Country

INTRODUCTION: Nearly ten years ago, Kansas sought to apply its Motor Fuel Tax Act to Indian tribes for the first time, touching off litigation that only recently concluded with the United States Supreme Court's decision in *Wagnon v. Prairie Band Potawatomi Nation*. The Potawatomi tribe ("the Nation") maintained a gas station to support an on-reservation casino and charged a tax on fuel sales. The Kansas tax, to be applied concurrently, would effectively nullify the tribal tax because simple economics dictated the two were mutually exclusive. The Court interpreted the relevant statute literally, holding it put the legal incidence of the tax on non-Indian distributors and was applied to their first receipt of the fuel, a transaction that occurred off-reservation. Applying these circumstances to established law, the Court ruled Kansas was within its sovereign authority to levy the tax. A dissent argued the incidence of the tax applied to an on-reservation transaction and fell on Indian retailers, and advocated the use of a balancing test.

BACKGROUND: For nearly 200 years, Supreme Court adjudication surrounding tribal-state relations emphasized concurrent sovereignty, preferring unilateral regulation of the tribes by the federal government. However, Court decisions over the last thirty-five years have gradually eroded tribal immunity

from state regulation, occasionally upholding state taxes that reach into jurisdictions that are historically Indian.

In certain circumstances the Court allowed states to levy taxes directly on the tribes or their members. For example, a New Mexico tax on the gross receipts a tribe earned from an off-reservation business venture was upheld in *Mescalero Apache Tribe v. Jones*. Similarly, in *Oklahoma Tax Commission v. Chickasaw Nation*, a state tax on income earned by Indians who lived off-reservation survived scrutiny. However, *California v. Cabazon Band of Mission Indians* prohibited a state from regulating on-reservation gaming ventures by Indian tribes. Thus, tribal enterprises and individual members may be subject to state taxation off the reservation, but are immune therein.

State attempts to tax non-Indians on the reservation proved more contentious, and the resulting doctrine more opaque. In general, states may impose taxes in these instances unless (1) doing so would infringe on the right of Indians to make their own laws, or (2) the state is preempted by Congress. In *White Mountain Apache Tribe v. Bracker*, the Court stated explicit statutory preemption is unnecessary. In that case, an Arizona fuel tax was invalidated because a combination of federal and tribal interests preempted its imposition. Incorporated into this interest-balancing test was the previously separate notion that states may not infringe on tribal autonomy.

The Court continues to apply the *Bracker* test in cases where states seek to tax non-Indian entities operating on tribal lands. In *Washington v. Confederated Tribes of the Colville Indian Reservation*, the Court upheld a state tax on cigarette purchases by non-Indians at stores located on reservations. Likewise, a state severance tax on oil drawn by a private company from reservation land was validated in *Cotton Petroleum Corp. v. New Mexico*.

Although the initial motor fuel tax statute was ambiguous, Kansas altered it sometime in the late 1990s to explicitly place the incidence on the distributor of first receipt. This appeared to effectively clear up any misconceptions. In *Kaul v. Kansas Department of Revenue*, the Kansas Supreme Court interpreted the statute as placing the incidence of the tax on non-Indians, and a federal district court agreed in *Winnebago Tribe of Nebraska v. Kline*. But curiously, the Tenth Circuit came to a different conclusion in *Prairie Band Potawatomi Nation v. Richards*, finding federal and tribal interests preempt the tax regardless of who bears its incidence. This misapplication required clarification and, thus, the stage was set for *Wagon*.

ANALYSIS: The Court's opinion in *Wagon* is premised on the clarity of the Kansas state legislature's assignment of the fuel tax incidence in section 79-3408(c). It also refers to the Kansas Supreme Court's interpretation of the statute in *Kaul*.

According to Justice Thomas, writing for the majority, because the Nation does not bear the burden of the tax and because the tax arises from an off-reservation transaction, it is valid.

In contesting the opinion, the Nation first argues that the statute actually puts the incidence on Indian retailers. This is because distributors may pass on the costs incurred by the tax to retailers at the point of sale. But the Court points out that distributors must calculate and physically pay the tax, and are not required to pass on the tax. Alternatively, the Nation argues the tax actually arises from the on-reservation delivery of the fuel, which would trigger the *Bracker* test. In support of this proposition, the Nation refers to sections 79-3408(a) and 79-3408(d) of the tax statute. Justice Thomas opts for a less expansive interpretation of those provisions, and relies on alternatives to distinguish the Nation's assertion.

Although not essential to the holding, the remainder of the opinion attempts to clarify the instances in which the application of the interest-balancing test is appropriate. Three points are important: (1) the state does not infringe on tribal sovereignty when, as here, the tax falls on a transaction occurring off the reservation; (2) the balancing test should not be applied simply because the state tax interferes with the tribe's own ability to tax; and (3) the Nation is not a territory exempted from the tax by statute.

In dissent, Justice Ginsburg argues for the imposition of the interest-balancing test. She points out that the taxes are mutually exclusive—although legally both the tribe and the state may tax the motor fuel, economic reality dictates that the two taxes together would raise the market price far above the competition. Thus, if the tax is upheld the incidence will ultimately fall on the tribe, since it will have to forego the tax revenue it had previously enjoyed and depended upon to maintain reservation roads. Accordingly, the tribe can demonstrate a compelling interest in avoiding the tax, and Justice Ginsburg argues it should be invalidated.

EVALUATION: The Court's opinion correctly interprets the incidence of the motor fuel tax and then applies the appropriate case law. The best way to demonstrate this is by comparing alternative treatments of the two overarching issues in *Wagnon*: (1) who bears the incidence of the tax, and (2) where geographically is the tax assessed? If the tax is born by Indians for sales made on the reservation, it is categorically barred. If the tax is imposed on non-Indians but occurs on the reservation, the *Bracker* test should be applied. If the tax is born by non-Indians and assessed off-reservation, as the Court rules, it is valid.

Assessing the first alternative, the tax is not categorically barred because the incidence does not fall on the

Nation. (Although the dissent advocates for affirming the *Richards* decision to the contrary.) It is certainly true that the state tax will affect the Nation by negating its ability to levy its own motor vehicle tax. However, both Justice Ginsburg and the Tenth Circuit make a logical misstep by equating the tax's *effect* on the Nation with the tax's *imposition* on the Nation. The two are simply not the same, certainly not enough to allow the Nation to overcome explicit language to the contrary from section 79-3408(c).

Regarding the second alternative, the *Bracker* test is not appropriate because, although the incidence of the tax is on the non-Indian distributor, it does not arise out of an on-reservation transaction. The dissent argues the tax is imposed on the on-reservation fuel sale from distributor to retailer, based on section 79-3408(d) of the statute, which states the "who" and "where" of the fuel sale are the criteria for determining which transactions are tax exempt. As a corollary, Justice Ginsburg suggests they must also be the criteria for determining which transactions are *taxed*. This is a complete misreading of the statute: section 79-3408(d) denotes when the tax *is not* imposed; it is section 79-3408(c) that states the method in which the tax *is* imposed. Section 79-3408(d) cannot be read backward to imply what transactions trigger the tax, and it need not be: section 79-3408(c) states them explicitly.

Even if the Court were to decide the incidence of the tax occurs on the reservation and applied the *Bracker* test, it is not clear the result would be any more favorable for the Nation. First, both the state and the tribe have an interest in maintaining the sovereign authority to tax. A finding against Kansas would prohibit its ability to tax the sale of motor fuel to distributors in situations where distributors might pass that tax down to Indian retailers. Alternatively, a finding against the Nation does not prohibit its ability to tax fuel at all. The tribe retains the power to levy its own tax concurrent with that of the state; it simply complains it cannot.

Second, both the state and the tribe have an interest in obtaining tax revenue. While a finding against Kansas appears more palatable, especially since the state apparently does not use the revenue it receives from the motor fuel tax to maintain the majority of reservation roads, there are a number of problems with this conclusion. First, it relies on the assumption that the state tax must be proportional to services provided by the state, which is not consistent with precedent. Second, it ignores the fact that Kansas applies a general tax, the proceeds of which go to finance state projects, some of which surely benefit the Nation. Finally, it suggests the Nation will be unable to procure alternative means of finance.

From a policy standpoint, the Court's decision in *Wagon* is

potentially disastrous for Indian tribes everywhere. Tax revenues are a valuable source of funding, and tribes who find their ability to levy taxes impaired by concurrent state taxes will be forced to find alternative sources of fiscal support for social services. Although this is certainly an area in need of attention, the inherent inequities of concurrent taxation are appropriately the province of Congress, and the Court is right to sidestep the issue. Furthermore, the tribes have several options to correct policy deficiencies: (1) they may seek Congressional legislation that explicitly abrogates taxes like the one Kansas seeks to apply; (2) they may contract with the states individually to achieve mutually beneficial results; or (3) they may rely on alternative business enterprises for tax exempt revenue, which can be used to fund tribal services.

CONCLUSION: In *Wagon*, the Supreme Court correctly read the operative state statute to determine that the incidence of a Kansas fuel tax was on non-Indian distributors and assessed off the reservation. The Court then applied the appropriate precedent to protect Kansas's sovereign authority to levy taxes on transactions within its own borders. The Court's ruling does not prohibit the Nation from levying a concurrent fuel tax on the reservation, and the tribe can mitigate any potential losses in tax revenue with the tax-exempt profits it earns from its casino or by seeking a nonjudiciary solution.