

Rejecting Balancing Tests and Limiting Indian Tax Immunity

INTRODUCTION: In *Wagnon v. Prairie Band Potawatomi Nation*, the Supreme Court considered the validity of a Kansas motor fuel tax imposed on a non-Indian distributor providing fuel to an Indian owned and operated reservation gas station. Asserting that this application of the fuel tax was an "impermissible affront to its sovereignty," the Prairie Band Potawatomi Nation ("Nation") filed suit in federal district court to enjoin Kansas from levying the tax on fuel sold to the Nation. However, the district court granted summary judgment in favor of the state.

On appeal, the Tenth Circuit reversed and invalidated Kansas' tax as applied to fuel distributed to the Nation. After balancing state, tribal, and federal interests, the court reasoned that "Kansas' generalized interest in raising revenues [was] insufficient to justify its tax" in light of the federal and tribal interests in "promoting tribal economic development, tribal self-sufficiency, and strong tribal governments." However, the Supreme Court ultimately reversed, holding that Kansas' tax as applied to the fuel distributors is valid and does not infringe upon the Nation's sovereignty. Furthermore, the Court determined that the interest-balancing test relied on by the lower courts is inapplicable when the challenged tax is directed at the off-reservation activities of non-Indians.

BACKGROUND: The U.S. Constitution specifically grants

Congress the power to regulate commerce with Indian tribes. Thus, Congress' specific grant of power, together with the inherent sovereignty of Indian tribes, creates distinct barriers of federal preemption to states attempting to exercise regulatory functions over Indian reservations and tribal members. Modern jurisprudence addressing the tension between Indian sovereignty and states' regulatory powers can be traced back to *Williams v. Lee*. In *Williams*, the Court held that Arizona could not exercise jurisdiction over a non-Indian's claim arising from an on-reservation business transaction with an Indian. Attempting to develop a framework for evaluating the scope of state power vis a vis the Indians, the Court reasoned that allowing jurisdiction would encroach on the right of Indian self-government. However, in *Mescalero Apache Tribe v. Jones*, the Court distinguished off-reservation tribal activities and held that the tribal operation of an off-reservation ski resort was subject to New Mexico's gross receipts tax.

As the case law evolved, the Court recognized the need for a more "particularized inquiry into the nature of the state, federal, and tribal interests at stake . . . to determine whether, in the specific context, the exercise of state authority would violate federal law." Therefore, in Indian tax cases:

[T]he initial and frequently dispositive question . . . is who bears the legal incidence of [the] tax. If 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. But if the legal incidence of the tax rests on non-Indians, no categorical bar prevents enforcement of the tax; if the balance of federal, state, and tribal interests favors the State, and federal law is not to the contrary, the State may impose its levy[.]

The application of this interest-balancing test frequently results in a judgment against the state when the incidence of a tax or regulation is directed at on-reservation activities. Nevertheless, a state's legitimate interest in a tax directed at non-Indians may still outweigh tribal interests, even if that tax indirectly burdens on-reservation activity.

Furthermore, the legal incidence of a tax is not immutable, and the Court has signaled that state legislatures can amend existing law to shift the incidence of a tax. The Court has also implied that such a shift may yield a more permissive result for the state. In light of this suggestion, Kansas amended its motor fuel tax, and shifted the legal incidence of the tax to fuel distributors. However, this modification did not foreclose lower court applications of the *Bracker* interest-balancing test in cases where the legal incidence of the tax fell on the off-reservation receipt of fuel by distributors.

ANALYSIS: The Court granted certiorari in *Wagon* to determine whether Kansas' fuel tax on a non-Indian distributor's off-reservation receipt of fuel should be subject to the *Bracker* interest-balancing test when that fuel is subsequently sold on-

reservation to an Indian fuel station. In an opinion by Justice Thomas, the Court holds that the *Bracker* balancing test should not be applied to the Kansas fuel tax. However, prior to determining the applicability of the balancing test, the Court considers the Nation's assertion that the Kansas tax is imposed on the distributor's "on-reservation sale and delivery" of fuel, and not on the off-reservation receipt of fuel.

While the Court acknowledges that a tax imposed on a non-Indian seller may be pre-empted "if the transaction giving rise to the tax liability occurs *on the reservation* and the imposition of the tax fails to satisfy the *Bracker* interest-balancing test[,]" the Court determines that due to the "dispositive language" of the statute, the triggering event for the Kansas tax is the distributor's receipt of fuel, not the subsequent delivery of that fuel. Furthermore, the Court determines that notwithstanding certain tax deductions and refunds available to the distributor under the statute, the distributor's tax liability is determined by the amount of fuel *received* by the distributor in a given month, and not on the amount of fuel sold by the distributor. Therefore, the Court rejects the Nation's first claim that the incidence of the tax is directed at the distributor's on-reservation sale and delivery of fuel.

The Court then holds that the *Bracker* interest-balancing test is inapplicable to the Nation's case, and refuses to extend

the application of the balancing test to situations where a state exercises "its taxing authority over non-Indians off the reservation." The Court reasons that by limiting the *Bracker* interest-balancing test to on-reservation transactions, the Court is both progressing toward the development of a bright-line standard in the area of Indian tax immunity jurisprudence, and reaffirming the importance of "special geographic sovereignty concerns that give rise to the test[.]" Finally, the Court rejects the Nation's claim that the tax is "impermissibly discriminatory" because tax exemptions are provided to fuel sold to other sovereigns. In holding that the tax is not "impermissibly discriminatory," the court reasons that the Nation is similarly situated to all Kansas retailers effected by the tax, and that the Nation benefits from state highway programs funded by the tax.

In dissent, Justice Ginsburg, joined by Justice Kennedy, challenges the Court's refusal to apply the *Bracker* balancing test. Proposing a much broader interpretation of the test, Ginsburg asserts that the Court should query whether the ultimate economic burden of the tax falls on the Nation, not whether the activity giving rise to the tax occurs on or off the reservation. Ginsburg also maintains that "Kansas' placement of the legal incidence of the fuel tax is not as clear and certain as the State suggest and the Court holds." By focusing on the

application and exemptions of the tax, Ginsburg proposes that the Kansas legislature has not truly shifted the burden of the tax from the Indian retailer to the distributor.

Moreover, Ginsburg contends that even if the legislature had shifted the entire tax burden to the distributor, the Court's decision in *Chickasaw* mandates that such a shift "trigger-not foreclose-interest balancing." Furthermore, Ginsburg argues that the majority's purported "bright-line" standard will only provide states with greater power to burden on-reservation activities and will dilute the principles of tribal sovereignty and self-government. Finally, after applying the *Bracker* balancing test to the Kansas tax, Ginsburg determines that invalidating the tax would lead to a more equitable disbursement of tax revenue for road maintenance in the State of Kansas.

EVALUATION: The Court's opinion in *Wagnon* yields to the development of manageable standards in an area of law commonly criticized as inconsistent and unpredictable. Through careful application of prior precedent, the Court properly restricts the *Bracker* interest-balancing test to the review of on-reservation activity and creates a bright-line rule for lower courts to follow. Moreover, the Court's decision to limit the *Bracker* test's applicability will ultimately curtail the flow of litigation and encourage tribes to seek other avenues of redress.

In light of the dispositive language of the Kansas statute,

and the Court's prior suggestion in *Oklahoma Tax Commission v. Chickasaw Nation*, the Court properly determined that the incidence of the motor fuel tax was on the distributor and not on the Nation retailer. While the Nation is arguably effected by the imposition of the tax, the Court's determination properly distinguishes the legal incidence from the indirect burden of a tax. Furthermore, if the Court had accepted the notion that an indirect burden should be equated with the incidence of a tax, the Court would have effectively abrogated the holdings of *Washington v. Confederated Tribes of the Colville Indian Reservation* and *Cotton Petroleum Corp. v. New Mexico*, which permit the indirect burden of on-reservation activities.

Moreover, the Court appropriately recognizes that the *Bracker* balancing test was developed in an effort to address special concerns of Indian geographical sovereignty and self-government. Therefore, the Court reaches a logical conclusion in determining that the *Bracker* test should not be extended to activity occurring outside of the geographical bounds of the reservation. The Court's refusal to extend the test is further consistent with its ruling in *Chickasaw*, which confirms that tribal members do not receive the same protections against the state outside of the reservation.

Furthermore, while Justice Ginsburg may favor *ad hoc* litigation, the majority's bright-line rule limiting the scope of

the *Bracker* test achieves several important objectives. First, the Court's holding provides guidelines for litigants, thus increasing efficiency and reducing the flow of litigation. Additionally, the Court's refusal to extend the *Bracker* test is illustrative of the notion that Congress is better suited than the Court to balance tribal, state, and federal interests. As one commentator notes, "Congress has never specifically addressed the problem of state taxation of Indian reservation land and activities." Perhaps in light of the Court's decision, Congress will take the initiative to enact regulatory measures, such as federal Indian tax credits, to address the burdens of indirect state taxation on Indian tribes. Moreover, the Court's decision may encourage tribes to take a proactive role in negotiating and executing tax agreements, or tax compacts, with states to protect their sovereign interests.

CONCLUSION: Although the outcome of *Wagnon* may seem unduly harsh from the perspective of the Nation, the Court's rejection of the *Bracker* interest-balancing test was a necessary progression toward Indian tax law uniformity. The Court's holding is entirely consistent with prior decisions and reinforces the notions of on-reservation sovereignty and self-government. Furthermore, while the Court's decision may foreclose judicial balancing of off-reservation taxation schemes, tribal communities burdened by such schemes are not left without

a remedy and may still look to Congress, or alternatively to states, to effectuate their interests.