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States Versus Tribes: The Problem of Multiple Taxation of Non-Indian Oil and Gas Leases on Indian Reservations

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NOTES

STATES VERSUS TRIBES: THE PROBLEM OF MULTIPLE TAXATION OF NON-INDIAN OIL AND GAS LEASES ON INDIAN RESERVATIONS

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I. Introduction

Taxation of business operations on Indian land presents a murky issue, particularly when the business operations involve non-tribal members engaging in business on Indian lands. One context where this issue often arises is in the field of natural resources. Because oil and gas are such important commodities, not just on and off American Indian reservations, but across the world, and because oil and gas transactions require a certain level of expertise, tribal dealings with non-Indians in this area are almost inevitable.

The central issue of this Note examines whether states may tax the operations of nontribal on-reservation businesses. Recently, the Ute Mountain Ute Tribe of New Mexico challenged state taxation of oil and gas leases on their lands.[1] While the district court determined that the state had no authority to tax the operations, the Tenth Circuit Court of Appeals in *Ute Mountain Ute Tribe v. Rodriguez*[2] disagreed, following in the footsteps of the United States Supreme Court in *Cotton Petroleum Corp. v. New Mexico*.[3] However, that decision was incorrect: state taxes of nonmember oil and gas operations on reservations must be analyzed on a case-by-case basis. *Rodriguez* should be distinguished from *Cotton* in a few, significant ways. *Rodriguez* presents an instance where state taxes on oil and gas production on reservations by nonmembers should be prohibited.

II. Law Before the Case

Taxation of non-Indians participating in business on Indian reservations has been an unanswered question for almost a century. There are three

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1. Ute Mountain Ute Tribe v. Homans, 775 F. Supp. 2d 1259, 1260 (D.N.M. 2009), *rev'd sub nom.* Ute Mountain Ute Tribe v. Rodriguez, 660 F.3d 1177 (10th Cir. 2011).

2. 660 F.3d 1177, 1180 (10th Cir. 2011), *cert. denied*, 132 S. Ct. 1557 (2012).

3. 490 U.S. 163 (1989).

potential taxation levels for these individuals or entities: federal taxation, state taxation, and tribal taxation.

A. Federal Taxation

The authority of the United States federal government to tax Indian tribes is uncontested. Article I of the U.S. Constitution allows Congress "[t]o regulate Commerce . . . with the Indian Tribes."[4] To this end, Congress has enacted legislation specifically designed to help clarify the treatment of Indian tribes with regard to federal taxation schemes.[5]

B. Tribal Taxation

The authority of tribes to impose taxes on non-Indians on their reservations is also uncontested. The ability to tax is "an essential attribute of Indian sovereignty" and is "a necessary instrument of self-government and territorial management."[6] This taxing authority comes from the tribe's "general authority, as sovereign, to control economic activity within its jurisdiction," rather than from its power to exclude non-Indians from its lands.[7] Thus, courts continue to uphold tribal taxation of non-Indians entering their reservations for the purpose of engaging in business.[8]

Over time, the criteria for determining whether a tribe may tax non-members within the limits of the reservation has been narrowed to a single test, known as the *Montana* Test.[9] This test concedes that tribes may not generally regulate non-members within their lands unless: (1) the non-Indians have entered a consensual business relationship with the tribe or its members or (2) the non-Indian conduct directly affects the "political integrity, the economic security, or the health or welfare of the tribe."[10] While these two exceptions have been narrowed by recent Supreme Court decisions, energy development on Indian reservations can still trigger both exceptions.[11]

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4. U.S. CONST. art. I, § 8, cl. 3.

5. *See, e.g.*, 26 U.S.C. § 7871 (2012).

6. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 137 (1982).

7. *Id.*

8. Heather J. Tanana & John C. Ruple, *Energy Development in Indian Country: Working Within the Realm of Indian Law and Moving Towards Collaboration*, 32 UTAH ENVTL. L. REV. 1, 16 (2012).

9. Bethany C. Sullivan, Note, *Changing Winds: Reconfiguring the Legal Framework for Renewable-Energy Development in Indian Country*, 52 ARIZ. L. REV. 823, 836 (2010); *see also* Montana v. United States, 450 U.S. 544 (1981).

10. *Montana*, 450 U.S. at 565-66.

11. Tanana & Ruple, *supra* note 8, at 16-17.

In addition to the contraction of these exceptions, tribes have, over time, seen the erosion of their taxing power in general.[12] This problem is exacerbated by the authorization of federal and state taxes within the jurisdictions of tribal taxes.[13] The imposition of state taxes hinders the ability of tribes to levy their own taxes, decreases the value to the tribes of oil and gas leases, and makes on-reservation leasing less attractive to contractors.[14]

C. State Taxation

1. Congressional Approval

While federal and tribal authority to levy taxes on non-Indians is mostly settled, state authority has remained an open question for nearly a century. Generally, states cannot tax tribes or tribal members engaging in business on Indian reservations.[15] The exception to this rule occurs when Congress has explicitly authorized taxation.[16] Courts may not allow state taxation on tribal members on reservations under an ambiguous statute.[17] However, tribal members are subject to state taxation on activities in which they participate off reservation.[18] The remaining question, then, concerns state taxation of on-reservation activities of *non-Indians.*[19]

Federal authorization of state taxation on Indian reservations has changed dramatically over time. In 1832, the Supreme Court declared that a "[s]tate has no jurisdiction at all within the boundaries of a reservation."[20] However, over a century later the Court adjusted this rule to consider the

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12. Angelique A. EagleWoman, *The Philosophy of Colonization Underlying Taxation Imposed upon Tribal Nations Within the United States*, 43 TULSA L. REV. 43, 50 (2007). For a detailed discussion of the erosion of tribal taxing power, see Philip P. Frickey, *A Common Law for Our Age of Colonialism: The Judicial Divestiture of Indian Tribal Authority over Nonmembers*, 109 YALE L.J. 1, 49 (1999).

13. EagleWoman, *supra* note 12, at 50.

14. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 186-87 (1989).

15. Mark J. Cowan, *Double Taxation in Indian Country: Unpacking the Problem and Analyzing the Role of the Federal Government in Protecting Tribal Governmental Revenues*, 2 PITTSBURGH TAX REV. 93, 108 (2005).

16. *Id.*

17. *Id.*

18. *Id.*

19. *See generally Cotton*, 490 U.S. 163 (1989); Ramah Navajo Sch. Bd., Inc. v. Bureau of Revenue, 458 U.S. 832 (1982); White Mountain Apache Tribe v. Bracker, 448 U.S. 136 (1980); Ute Mountain Ute Tribe v. Rodriguez, 660 F.3d 1177 (10th Cir. 2011).

20. Ute Mountain Ute Tribe v. Homans, 775 F. Supp. 2d 1259, 1276 (D.N.M. 2009) (citing Worcester v. Georgia, 31 U.S. (6 Pet.) 515, 561 (1832)).

state's legitimate interest in regulating non-Indians, and "whether the state action infringe[s] on the right of reservation Indians to make their own laws and be ruled by them."[21] States generally cannot tax on-reservation activity unless Congress has expressly authorized that taxation.[22]

In 1891, Congress first authorized mineral leasing on statutory and treaty (but not executive) reservations.[23] Thirty-three years later, in 1924, Congress enacted the first legislation related to the taxation of oil and gas production on Indian lands.[24] "The 1924 Act provided expressly for state taxation of oil and gas produced from Indian lands,"[25] waiving tribes' intergovernmental sovereign immunity in that area.[26] Thus, treaty and statutory reservations were immune from state taxation from 1891 until 1924.

Since 1924, Congress has enacted two laws that have been used by proponents to argue that state authority to tax has been nullified. In 1938, Congress enacted the Indian Mineral Leasing Act (IMLA).[27] The IMLA had three stated purposes: first, to provide uniformity in Indian land leasing; second, to harmonize leasing with the Indian Reorganization Act of 1934;[28] and third, to ensure Indian owners receive the highest return on income derived from their property.[29] However, this Act did nothing to change the state tax structure affecting oil and gas businesses on Indian lands.[30] Indeed, while part of the purpose of the IMLA was to make sure that the Indians receive "the greatest return on the income derived from their property,"[31] Congress never intended that this Act remove all possible hurdles to tribal profit maximization.[32] Notably, the Supreme Court refused to accept the assertion that the IMLA's silence on the issue of taxation repealed the 1924 Act's authorization of state taxation.[33]

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21. Williams v. Lee, 358 U.S. 217, 271 (1959).
22. *Id.* at 223.
23. *Rodriguez*, 660 F.3d at 1192.
24. *Id.* at 1193; *see* 25 U.S.C. § 398 (2012).
25. EagleWoman, *supra* note 12, at 55.
26. *Rodriguez*, 660 F.3d at 1193.
27. 25 U.S.C. § 396a (2012).
28. 25 U.S.C. §§ 461-479 (2012).
29. EagleWoman, *supra* note 12, at 56.
30. *Id.*
31. *Id.*
32. Tanana & Ruple, *supra* note 8, at 18 (citing Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 180 (1989)).
33. *Cotton*, 490 U.S. at 182.

Congress next addressed oil and gas on Indian lands with the passage of the Indian Mineral Development Act (IMDA), enacted in 1982.[34] Similar to the IMLA, the purpose of the IMDA is to "maximize the economic return to a tribe for its oil and gas,"[35] and, like the IMLA, the IMDA is silent on the issue of state taxation.[36] However, this Act allows the Secretary of the Interior to "promulgate regulations to implement the IMDA."[37] Again, courts refuse to accept the assertion that this Act repeals the 1924 Act's authorization of state taxes.

2. Judicial Approval

The Supreme Court has developed a second approach to determine whether a state has jurisdiction.[38] A state may sometimes be able to prove a compelling enough interest to warrant state taxes even without congressional approval.[39] When determining the validity of state taxes, courts must consider tribal sovereignty as a backdrop against which all other laws must be interpreted.[40] Courts should look at: (1) the federal interest in on-reservation activity; (2) the tribal interest in the operation; and (3) the state's interest in taxing the operation.[41] It is worth noting that a state tax is not immediately invalidated solely because the economic burden falls on the tribe.[42]

The first two major Supreme Court decisions to address the problem of double taxation, *White Mountain Apache Tribe v. Bracker*[43] and *Ramah Navajo School Board, Inc. v. Bureau of Revenue*,[44] both denied the imposition of state taxes over non-Indians engaging in on-reservation activities. In denying states this authority, both cases made clear that the analysis used to determine whether or not state taxes are preempted is flexible and depends on the facts of the specific case.[45]

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34. 25 U.S.C. § 2012 (2012).

35. Thomas W. Fredericks, *Freeing Indian Energy Development from the Grips of* Cotton*: Advancing Energy Independence for Tribal Nations*, FED. LAW., Apr. 2013, at 57, 58.

36. 25 U.S.C. § 2012 (2012).

37. Fredericks, *supra* note 35, at 58.

38. McClanahan v. State Tax Comm'n, 411 U.S. 164, 172 (1973).

39. Tanana & Ruple, *supra* note 8, at 18.

40. White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 144-45 (1980).

41. *Id.* at 149-50.

42. Ute Mountain Ute Tribe v. Rodriguez, 660 F.3d 1177, 1201 (10th Cir. 2011).

43. 448 U.S. 136.

44. 458 U.S. 832 (1982).

45. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 183-84 (1989).

Bracker addressed whether a state's motor carrier license and use fuel taxes applied to a non-tribal member logging company operating solely on roads within a reservation.[46] In resolving this case, the Supreme Court developed a balancing test to determine whose interests were most pervasive and therefore whether state taxes should apply.[47] This test, often referred to as the *Bracker* Balancing Test,[48] weighs the state, federal, and tribal interests at stake by considering three factors.[49] First, courts consider the extent of the federal and tribal regulations governing the taxed activities.[50] Second, courts consider whether the economic burden of the tax falls on the non-Indian individual or entity or on the tribe or tribal members.[51] Third, courts consider the extent of the state interests in the taxation.[52] Finally, when deciding whether or not the *Bracker* test applies, courts must consider on whom the legal incidence of the tax falls and where the taxable event occurs.[53]

In *Bracker*, the Court decided that the federal and tribal regulations were so pervasive that there was neither room nor reason to impose state taxation or regulations.[54] The imposition of state taxes would also hinder both the tribe's ability to comply with the sustainability policies prescribed by the federal government[55] and the federal government's ability to set fees and rates related to the harvest of the timber.[56] It was undisputed that the incidence of the taxes fell on the tribe.[57] Finally, the parties offered no evidence of "any regulatory function or services performed by the State that would justify the assessment of taxes for activities on Bureau and tribal roads within the reservation."[58] The roads cost the State nothing and the

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46. *Bracker*, 448 U.S. at 137-38.

47. *Id.* at 145.

48. The term "Bracker balancing" was originally coined by the District Court of New Mexico in *Ute Mountain Ute Tribe v. Homans*, 775 F. Supp. 2d 1259, 1279 (D.N.M. 2009). The Supreme Court has previously used the term "Bracker interest-balancing test." Wagnon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 100 (2005).

49. *Bracker*, 448 U.S. at 148, 150-51.

50. *Id.* at 148. For a discussion of the federal regulatory scheme governing timber activities on the Fort Apache Reservation, see generally *id.* at 146-50.

51. *Id.* at 151.

52. *Id.* at 150.

53. *Wagnon*, 546 U.S. at 105-106.

54. *Bracker*, 448 U.S. at 152.

55. *Id.* at 149-50.

56. *Id.* at 149.

57. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 184 (1989) (citing *Bracker*, 448 U.S. at 151).

58. *Bracker*, 448 U.S. at 148-49.

State had no control over them; therefore, the State had no reason to require revenues from their use.[59] Thus, all three prongs of the *Bracker* Balancing Test tipped in favor of the Tribe and the state taxes were consequently preempted. The next major case to apply the Bracker Balancing Test to preempt state taxes was *Ramah*, which involved taxation of a non-Indian construction company constructing a school for Indian children on Indian land.[60]

While state taxation is supposedly checked by this *Bracker* Balancing Test, considering the interests of all parties involved and weighing towards the tribal and federal interests in any instance of ambiguity, "this check appears to have been watered down by the Court over time,"[61] particularly by the seminal oil and gas taxation case, *Cotton Petroleum Corp. v. New Mexico*.[62]

Cotton represents a major turning point for state taxation of non-Indians on Indian lands. *Cotton* recognized that tribal taxes on oil and gas severed by non-Indians on Indian reservations, under that specific fact pattern were valid.[63] The *Rodriguez* court found this case particularly persuasive because it involved the same five taxes.[64]

In applying the *Bracker* Balancing Test, the Supreme Court substantially distinguished *Cotton* from *Bracker* and *Ramah*, and upheld state taxation of the non-Indian on-reservation activities. The Court determined that because the State "regulates the spacing and mechanical integrity of wells located on the reservation," the federal and tribal regulatory schemes are extensive, but not exclusive.[65] The State additionally "provides substantial services to both the Jicarilla Tribe and Cotton costing the State approximately $3 million per year,"[66] indicating a legitimate state interest in raising revenues from the on-reservation activities. While the amount of taxes paid by the tribe significantly outweighs the cost of the services to the state, the Court points out that neither *Bracker* nor *Ramah* required a proportionality analysis as part of the test; they merely required showing a legitimate state

59. *Cotton*, 490 U.S. at 184.
60. Ramah Navajo Sch. Bd., Inc. v. Bureau of Revenue, 458 U.S. 832, 834 (1982).
61. Sullivan, *supra* note 9, at 838.
62. *See Cotton*, 490 U.S. 163.
63. *Id.* at 190-91.
64. Ute Mountain Ute Tribe v. Rodriguez, 660 F.3d 1177, 1188-89 (10th Cir. 2011).
65. *Cotton*, 490 U.S. at 186.
66. *Id.* at 185 (internal quotations omitted).

interest.[67] Finally, the Court noted that absolutely no economic burden from the taxes fell on the tribe.[68]

In this case, all three factors of the *Bracker* Balancing Test appear to tip in favor of the State.[69] This puts *Cotton* on the complete opposite end of the scale from *Bracker* and *Ramah*.

III. Statement of the Case

Courts now have an established framework against which they can examine disputes arising between tribes and states. However, most of the major cases have fallen entirely to one side of the analysis: either all three factors tip in favor of the tribe, as in *Bracker* and *Ramah*, or all three tip in favor of the state, as in *Cotton*. But what happens when the facts are less dispositive, when some factors tip in favor of the tribe and others for the state? This question was presented in *Ute Mountain Ute Tribe v. Rodriguez*.[70]

In *Rodriguez*, the U.S. District Court for New Mexico and the Tenth Circuit Court of Appeals were asked to decide "whether federal law preempts five state taxes imposed on non-Indian lessees extracting oil and gas from the Ute Mountain Ute Reservation ("Ute Reservation") in New Mexico."[71]

The Ute Mountain Ute Tribe (UMUT) is a federally recognized American Indian Tribe with roughly 2000 members.[72] The Ute Reservation spans across three states: New Mexico, Utah, and Colorado.[73] Originally established by treaty in 1868, Congress has twice reduced the size of this reservation; consequently, the reservation is both a treaty and statutory reservation, but not an executive reservation.[74] The portion of the reservation in New Mexico is used only for grazing and the extraction of minerals.[75] There are no "state-regulated or state-maintained roads or other infrastructure" on the reservation land in New Mexico.[76]

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67. *Id.*
68. *Id.*
69. *Id.* at 185-86.
70. 660 F.3d 1177 (10th Cir. 2011).
71. *Id.* at 1179.
72. *Id.* at 1180.
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.*

Under the IMLA[77] and the IMDA,[78] the UMUT is authorized, subject to approval by the Secretary of the Interior, to execute mineral leases and mineral development agreements.[79] As of July 2011, the Ute Reservation hosts 186 active oil and gas wells, operated by twelve oil and gas companies.[80] Natural gas is the reservation's main resource; oil is secondary.[81]

The Tenth Circuit found that the federal laws and regulations concerning oil and gas operations on Indian land, control "virtually every aspect" of the operations on the Ute Reservation.[82] However, the court conceded that the Oil and Conservation Division of the New Mexico Energy, Minerals, and Natural Resources Department (NMOCD) does have a minor role on the reservation:[83] the Bureau of Land Management has adopted the same standards for well spacing and well setbacks as those promulgated by the NMOCD.[84] Additionally, the State provides some optional on-reservation services to non-Indian operators, such as a hearing process for resolving disputes between operators, publicly available geologic records and production records, and records of transfers and sales.[85] These services are rarely, if ever, actually used. [86]

In addition to the federal and tribal taxes imposed, the State of New Mexico imposes five state taxes on non-Indian oil and gas operators extracting resources from Indian lands:[87] the Oil and Gas Severance Tax, the Oil and Gas Conservation Tax, the Oil and Gas Emergency School Tax, the Oil and Gas Ad Valorem Production Tax, and the Oil and Gas Production Equipment Ad Valorem Tax.[88] "Revenues from the Oil and Gas Severance Tax are used to meet the State's debt and put into the State's general fund";[89] "[r]evenues from the Oil and Gas Emergency School Tax are [also] put into the State's general fund."[90] Revenues from the Oil and

77. *See supra* Part II.C.1.
78. *Id.*
79. *Rodriguez*, 660 F.3d at 1180-81.
80. *Id.* at 1181.
81. *Id.*
82. *Id.*
83. *Id.* at 1182.
84. *Id.*
85. *Id.* at 1182-83.
86. *Id.* at 1183.
87. *Id.*
88. *Id.*
89. Ute Mountain Ute Tribe v. Homans, 775 F. Supp. 2d 1259, 1271 (D.N.M. 2009).
90. *Id.*

Gas Ad Valorem Production Tax and the Oil and Gas Ad Valorem Production Equipment Tax are primarily allocated to local governments.[91] Finally, "[r]evenues from the Oil and Gas Conservation Tax are partly used by the NMOCD to survey and plug abandoned, unplugged, or improperly plugged wells and partly put into the State's general fund."[92] While the NMOCD offers these services to the tribe, the NMOCD has never actually plugged an abandoned well on the Ute Reservation; the state provides no services directly to the UMUT.[93] In fact, the UMUT has barred the NMOCD from entering the Ute Reservation without permission since 1992 because the UMUT does not recognize the NMOCD's authority over oil and gas on their lands; rather, the tribe contends that authority is shared by the UMUT, the BLM, and the BIA, to the exclusion of the NMOCD.[94]

To determine the validity of state taxes, courts must decide whether federal law preempts or allows state taxes. As stated in Part II, the IMLA and the IMDA are silent: Congress neither prohibits nor authorizes state taxes in either of these statutes.[95] Next, courts must look at the background of tribal sovereignty with regard to the specific Indian tribe at hand. Here, the Tenth Circuit held that the UMUT's background of sovereignty did not weigh in favor of preemption of state taxes. While this reservation is a treaty and statutory reservation and was immune from state taxation from 1891 until 1924,[96] the Tenth Circuit held that this did not swing the analysis in favor of the tribe.[97]

Once courts have considered the relevant federal legislation and the background of tribal sovereignty, courts apply the *Bracker* Balancing Test. This test examines the weight of the state, federal, and tribal interests at issue by looking at three factors: (1) the extent of the federal and tribal regulations governing the taxed activity; (2) whether the economic burden of the tax falls on the non-Indian individual or entity or tribe; and (3) the extent of the state interest in the taxes.[98]

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91. *Id.*

92. *Id.*

93. *Id.* at 1272, 1274.

94. *Id.* at 1270.

95. *See infra* Part II.B.1.

96. EagleWoman, *supra* note 12, at 55.

97. Stephanie J. Boehl & Robert L. Mahon, *U.S. Supreme Court Update*, J. MULTISTATE TAX'N & INCENTIVES, Mar.-Apr. 2012, at 44, 45.

98. White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 148, 150-51 (1980).

Courts are attempting to establish a bright line rule to determine when the *Bracker* Balancing Test should be applied.[99] The rule looks at whom the incident of the tax falls on and where the taxable event occurs.[100] The district court determined that because the incidence of the tax fell on the non-Indian operators and because at least part of the activity, the severance of the oil and gas, occurred on the Ute Reservation, the *Bracker* Balancing Test was applicable.[101]

Both the New Mexico District Court and the Tenth Circuit followed the analysis established by the Supreme Court and relied heavily on the precedent set by *Cotton* to determine whether or not the state taxation was valid.[102] Each court began by considering the relevant Congressional legislation, namely the IMLA and the IMDA.[103] Next, the courts looked at the UMUT's specific history of sovereign immunity. Both courts found the historical backdrop notably different from the backdrop in *Cotton*. While the district court found the difference legally significant,[104] the Tenth Circuit did not.[105]

Finally, the courts considered the extent of the state interests in the taxes. The district court and the Tenth Circuit disagreed on this question. The *Bracker* test requires that the benefits of state taxation raised through on-reservation activity must specifically apply to the tribe; a general interest in raising revenue is not a sufficient state interest.[106] While the district court found in favor of the tribe,[107] the Tenth Circuit found the federal and tribal schemes extensive but not exclusive.[108] Citing the regulatory support and off-reservation infrastructure provided by the State of New Mexico, the Tenth Circuit concluded that federal law does not preempt state taxation.[109]

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99. *Homans*, 775 F. Supp. 2d at 1279.

100. *Id.* at 1279-80 (citing Wagnon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 100 & 107 (2005); Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 458 (1995)).

101. *Id*. at 1280.

102. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163 (1989).

103. *See Homans*, 775 F. Supp. 2d at 1287; Ute Mountain Ute Tribe v. Rodriguez, 660 F.3d 1177, 1190-92 (10th Cir. 2011). *See also* discussion *supra* Part II.C.1.

104. *Homans*, 775 F. Supp. 2d at 1287.

105. *Rodriguez*, 660 F.3d at 1194.

106. White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 150 (1980).

107. *Homans*, 775 F. Supp. 2d at 1292.

108. *Rodriguez*, 660 F.3d at 1196.

109. *Id.* at 1203.

Following the Tenth Circuit decision, the UMUT appealed to the Supreme Court; however, the Court denied certiorari on February 21, 2012.[110]

IV. State Taxes Should Not Generally Be Imposed on Non-Indian Oil and Gas Production on Indian Lands

A. This Case Falls Between Cotton *on One Hand and* Bracker *and* Ramah *on the Other*

As mentioned in Part III, the district court and the court of appeals differed in their application of the *Bracker* balancing test.[111] While the district court found that the backdrop of tribal sovereignty and the slightness of the state interest tipped the case in favor of the tribe, the court of appeals found that the backdrop of tribal sovereignty was not legally significant and that the state interest was sufficiently compelling.[112]

The Tenth Circuit found *Cotton* to be controlling because that case involved the same five taxes at issue in *Rodriguez*.[113] However, this case is distinguishable from *Cotton* in a few important ways. First, the Ute Reservation was created by treaty and statute;[114] conversely, the Jicarilla Apache Tribe reservation, which was at issue in *Cotton*, was created by Executive Order.[115] Second, while the district court in *Cotton* found that the economic burden on the tribe was not sufficiently high enough to invalidate the state taxes,[116] the district court in *Rodriguez* found that the economic burden on the UMUT, while indirect, was substantial.[117] These distinctions should be considered more carefully to determine which way they tip the scale.

1. Types of Reservations

Reservations are areas of land permanently reserved for a specific tribe as a tribal homeland.[118] Historically, reservations have been created three ways: by treaty, by an act of Congress, or by an Executive Order or

110. *See Rodriguez*, 660 F.3d 1177, *cert. denied*, 132 S. Ct. 1557 (2012).
111. *See supra* Part III.
112. *Id.*
113. Boehl & Mahon, *supra* note 97, at 44-45.
114. *Rodriguez*, 660 F.3d at 1180.
115. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 168 (1989).
116. *Id.* at 171-72.
117. *Rodriguez*, 660 F.3d at 1198.
118. *Indian 101 Questions and Answers*, CDC, http://www.cdc.gov/omhd/tcp/pdfs/indian 101factsheet.pdf (last visited Jan. 10, 2014).

Agreement.[119] While reservations may still be allotted, no treaties have been made between the United States and Indian tribes since 1871.[120] While the different types of reservations are similar, Congress and the courts do not see them as exactly the same. The history of state taxation of on-reservation activities has differed between the different types. While treaty and statutory reservations were immune from state taxes from 1891 until 1924,[121] "as to Executive Order reservations, state taxation of nonmember oil and gas lessees was the norm from the very start."[122]

The Tenth Circuit in *Rodriguez* did not find this distinction very important or legally significant.[123] That was incorrect: the period of complete state tax immunity from 1891 until 1924 clearly applies to the treaty and statutorily created Ute Reservation. Executive reservations, like the Jicarilla Apache Reservation in *Cotton*, did not receive this immunity. In addition, the question of whether or not state taxes are applicable should not even arise under executive reservations. While the question remains ambiguous under the IMLA and the IMDA, 25 U.S.C. § 398c specifically allows state taxation of leases on executory reservations: "[t]axes may be levied and collected by the State or local authority upon improvements, outputs of mines or oil and gas wells, or other rights, property, or assets of any lessee upon lands within Executive order Indian reservations . . . ."[124] Because treaty and statutory leases have no similar provision, courts should infer that the difference in creation and background is significant. Accordingly, they should treat this backdrop as "a thumb on the scales" in favor of tribes holding treaty and statutory reservations, such as the Ute Reservation.[125]

2. Incidence of the Economic Burden

As the dissent in *Rodriguez* points out, *Cotton* "strongly suggests" that the severity of the economic burden created by taxes on the tribe should be determined by the finder of fact: generally, the district court.[126] While the district court in *Cotton* found that the economic burden on the tribe was not

119. *Id.*

120. *Frequently Asked Questions*, U.S. DEP'T OF THE INTERIOR: INDIAN AFFAIRS, http://www.bia.gov/FAQs/ (last visited Jan. 10, 2014).

121. *Rodriguez*, 660 F.3d at 1194.

122. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 182 (1989).

123. *Rodriguez*, 660 F.3d at 1194.

124. 25 U.S.C. § 398c (2012).

125. Ute Mountain Ute Tribe v. Homans, 775 F. Supp. 2d 1259, 1194 (D.N.M. 2009).

126. *Rodriguez*, 660 F.3d at 1204.

sufficiently high,[127] the district court in *Rodriguez* came to the opposite conclusion.[128] Extreme deference should be given to this conclusion. While the *Rodriguez* court recognizes the importance of this deference, it refuses to follow it.

The economic burden of the tax refers to where the incidence of the tax falls. The economic burden on the tribe can be direct or indirect. A direct burden occurs when the incidence or cost of the taxes falls directly on the tribe, i.e., the tribe pays the taxes. An indirect burden, on the other hand, happens when someone else pays the tax and passes the cost on to the tribe. For instance, the *Ramah* Court determined that an indirect burden fell on the tribe when independent, non-Indian contractors building a school on the reservation included the state gross receipts taxes in the price of their bids.[129] Even though the tax was imposed on another party, because the tax was passed on to the tribe, the tribe bore the economic burden of the tax.[130] By the 1940s, it was already established that the indirect economic burden of a state tax does not, by itself, invalidate the tax.[131] However, the Court in *Oklahoma Tax Commission v. Texas Co.* emphasized the slightness of the tax at issue, implying that a larger tax might be problematic.[132]

Once the determination has been made that the burden of the tax falls on the tribe, courts should look at the proportionality of the imposed taxes to the amount of services rendered. The *Cotton* Court pointed out that neither *Bracker* nor *Ramah* required a proportionality analysis; they merely required a legitimate state interest.[133] However, the state did not have a legitimate interest in either of those cases. Therefore, those cases tipped entirely in favor of the tribes without needing to go further. In cases where there is a legitimate state interest and the economic burden falls on the tribe, either directly or indirectly, courts should take the next step and consider the amount of proportionality in determining the validity of the state taxes.

This does not mean that the amount of the tax or tax burden must not exceed the services rendered. Rather, they must be appropriate under the circumstances. For instance, Cotton Petroleum argued that, while New

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127. *Cotton*, 490 U.S. at 171.

128. *See Rodriguez*, 660 F.3d at 1204.

129. Ramah Navajo Sch. Bd., Inc. v. Bureau of Revenue, 458 U.S. 832, 835 (1982).

130. *Id.*

131. Comment, *The Case for Exclusive Tribal Power to Tax Mineral Lessees of Indian Lands*, 124 U. PA. L. REV. 491, 509 (1975) (citing Oklahoma Tax Comm'n v. Texas Co., 336 U.S. 342, (1949)).

132. 336 U.S. 342, 351 (1949).

133. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 185 (1989).

Mexico did provide its operations with almost $90,000 of services between 1981 and 1985, the imposition of almost $3,000,000 of state taxes was disproportionate to the amount of services rendered.[134] The Court rejected this argument for two reasons. First, the services are available to both lessees and the tribe, "the intangible value of citizenship in an organized society is not easily measured in dollars and cents," and, most persuasively, the actual per capita expenditures for tribe members were equal or greater than the expenditures per non-Indian.[135] Second, there is no constitutional requirement that the tax benefit received by an ordinary commercial taxpayer must equal the amount of his or her tax obligations.[136]

The taxes at issue in *Cotton* would have been upheld regardless; even if required, the Court would not have reached the proportionality analysis because the state had a legitimate interest and because no economic burden from the tax fell on the tribe.[137] However, the proportionality discussion engaged in by the Court provides a good foundation for developing a proportionality test.

Assuming a legitimate state interest, if the economic burden falls on the tribe, courts should weigh the amount of the burden suffered by the tribe against the amount of services provided. As early as 1982, the Supreme Court speculated that a proportionality assessment might be appropriate.[138] Determining proportionality can be done by considering factors such as how substantial the state's support is, the number of services available to the tribe (even if the tribe does not actually partake of all of these services), and the per capita state expenditures per tribal member compared to the expenditures per non-Indian. This should be a fact specific, case-by-case analysis turning on the totality of the circumstances; no one metric should be dispositive. Similarly, strict dollar-to-dollar proportionality is not dispositive; rather, this test is a fairness analysis balancing the interests of both parties.

Rodriguez is much more analogous to *Bracker* and *Ramah* than it is to *Cotton*. The federal and tribal regulations available to the oil and gas operators are quite pervasive. Similarly, the NMOCD and the State of New Mexico provide no physical services or infrastructure on the New Mexico

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134. *Id.*

135. *Id.* at 189-90.

136. *Id.* at 190.

137. *Id.* at 169.

138. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 190 n.26 (1982). ("[T]he multiple taxation issue would arise only if a *State* attempted to levy a tax on [activity on tribal lands], which is more than the *State's* contact . . . would justify.").

lands to either the UMUT or to the oil and gas operators.[139] In fact, New Mexico provides no services directly to the tribe.[140] While the State does offer off-reservation services to the tribe, the tribe has never partaken of these services.[141] The State also offers services such as a hearing process for resolving disputes between operators, but these services have never been used to resolve disputes between operators on the UMUT lands because the tribal and federal remedies are so extensive.[142] The NMOCD budget for the 2007 fiscal year was $11,132,531.[143] It is not possible to fully separate the expenditures for the on-reservation wells from the expenditures off-reservation.[144] The only expense that can be separated is the cost of plugging a well; the NMOCD has not plugged a well on the UMUT land since at least 1992, and there is no evidence that the NMOCD plugged a well on the UMUT land before then.[145] While the benefits of the services offered off of the UMUT land may be substantial,[146] the State cannot identify any expenses specifically connected to the maintenance of tribal wells. Additionally, many of the off-reservation services potentially offered to the tribe, such as publicly available geologic records,[147] would remain open to the on-reservation operators, at little to no additional cost to the State, even if the state taxes were not imposed.[148] For these reasons, the proportionality analysis tips in favor of the tribe and the state taxes should not be upheld.

B. Should Cotton *Actually Control?*

Overall, *Rodriguez* is much more analogous with *Bracker* and *Ramah* than with *Cotton*. However, because *Cotton* and *Rodriguez* involve the same five taxes, courts and lawyers are quick to assume the analysis is the same. As illustrated in the case at hand, this assumption is unfounded. In *Cotton* there was no history of tribal immunity from state taxes, the state had a significant state interest, and no incidence of the tax fell on the tribe. In *Rodriguez*, on the other hand, the tribe historically enjoyed some

139. Ute Mountain Ute Tribe v. Homans, 775 F. Supp. 2d 1259 (D.N.M. 2009).
140. *Id.* at 1272.
141. *Id.*
142. *Id.* at 1272-73.
143. *Id.* at 1273.
144. *Id.*
145. *Id.*
146. *Id.*
147. *Id.* at 1272.
148. *Id.*

sovereign immunity, the state's interest was minimal, and the tax incidence affected the tribe.

Homans asks whether *Cotton* should be broadly construed to hold that oil and gas severances from Indian lands by non-Indians may always be subject to state taxes, regardless of where on the *Bracker* scale a specific case would fall.[149] If so, a fact specific analysis of each case would be unnecessary. *Homans* specifically rejects this conclusion, stating that *Cotton* "did not create a categorical rule" and "the *Bracker* analysis continues to apply."[150] *Rodriguez* implicitly agreed by applying the *Bracker* analysis: had *Cotton* created a general rule, the court would have had no reason to employ the *Bracker* test or indeed partake in any detailed analysis; rather, the court should have merely announced that the taxes were valid based on precedent and *Cotton's* categorical rule. Because the *Rodriguez* court did not do this, that court accepted the premise that state taxes are validated on a fact-specific basis. Thus, reframing the issue in terms of authorization, instead of preemption, is warranted.

C. Authorization Versus Preemption

While all legislation actually deals with whether state taxes are *authorized* on Indian lands, the courts always ask whether state taxes are *preempted*. Courts should reframe their phrasing to better align with the real question. While the two questions may sound similar on the surface, they are slightly different in their analyses.

Congress has specifically stated that state taxes may not be imposed without express authorization.[151] Thus, short of express authorization, courts should begin by assuming state taxes are not authorized and determine whether there is a legitimate reason to allow the state taxes, instead of presuming the taxes are valid and looking for a reason to preempt them. While either phrasing should theoretically come to the same conclusion, searching for authorization instead of preemption forces the courts to view the cases in the light most favorable to the tribes, who are generally the disadvantaged party in negotiations.

For instance, in enacting the IMDA, the Congressional Committee drafting the statute declined to include express taxation authority, choosing instead to rely on the Supreme Court's jurisprudence.[152] This indicates, if

149. *Id.* at 1286.
150. *Id.*
151. Cowan, *supra* note 15, at 108.
152. Ute Mountain Ute Tribe v. Rodriguez, 660 F.3d 1177, 1192 (10th Cir. 2011).

anything, Congress's neutrality on the issue.[153] This does not indicate a congressional intent to prohibit state taxation, nor does it indicate authorization. The *Rodriguez* court understood this to mean that, had Congress wished to prohibit state taxation with the IMDA, it would have specifically done so—looking for preemption. However, *Rodriguez* should have asked if, after the enactment of the IMDA, state taxation was still authorized under the new setup. While that framing would have in no way been dispositive to the case, it would have allowed the court to view the legislation more critically and more favorably to the UMUT. Because congressional approval is the prevailing way to authorize state taxes, this approach would have been more prudent and should be applied in future cases.

V. Problems of Double Taxation

Allowing both states and tribes to tax non-Indians engaging in business on reservations creates a unique problem of double taxation.[154] This problem would never be allowed in multistate or international tax considerations.[155] "In fact, much of the law in the multistate and international tax fields is concerned with ensuring that income is taxed no more and no less than once."[156] In addition to the economic inequities double taxation causes, commentators have raised several other issues resulting from the current tax structure, including the assault on tribal sovereignty, increased disadvantages of doing business on reservations, and advancing the deplorable economic conditions that exist on reservations. Furthermore, this is not an issue that affects just this tribe or this reservations; this issue affects all Indian tribes engaging in business with non-Indians on their lands.

A. Assault on Indian Sovereignty

"The Indian's power to tax can mean little if the states in which reservations are located are also permitted to impose taxes on the same activities."[157] Through jurisdictional reclassifications, tribes have seen their taxing power erode over time.[158] Through Supreme Court decisions like

153. *See id.*
154. Cowan, *supra* note 15, at 95.
155. *Id.* at 94.
156. *Id.*
157. Comment, *supra* note 131, at 507.
158. EagleWoman, *supra* note 12, at 50.

Cotton, tribal economic development has been further impeded.[159] "[A] tribe's civil regulatory power diminishes the further it moves away from the internal governing of its own members,"[160] and the more external taxes imposed on the tribe the less regulatory power the tribe retains. Without the economic burden of federal and state taxes, tribes would be much better situated to sustain themselves, rebuild economically, and provide for the health and welfare of their members.[161] Because of this, some tribes have argued that courts should disallow state taxes on non-Indians engaged in business on reservations whenever the taxes infringe upon tribal sovereignty, regardless of congressional preemption.[162]

The imposition of state taxes similarly hinders tribes' abilities to govern themselves. Some tribes have argued that regardless of congressional preemption, courts should eliminate state taxes that pose a threat to Indian sovereignty by infringing "on the right of reservation Indians to make their own laws and be ruled by them."[163] The Supreme Court has already accepted this argument with regard to state laws affecting tribal sovereignty within Indian country in non-tax areas.[164] For instance, in a 1959 action to collect for goods sold on credit,[165] the Supreme Court held that the tribal courts had broad criminal and civil jurisdiction and that the State of Arizona had accepted no such jurisdiction. [166] The Court further held that allowing Arizona jurisdiction "would undermine the authority of the tribal courts over Reservation affairs and hence would infringe on the rights of the Indians to govern themselves. It is immaterial that respondent is not an Indian."[167] In 1983, the Supreme Court held that the application of New Mexico hunting and fishing laws to on-reservation activity "would effectively nullify the Tribe's authority to control hunting and fishing on the reservation."[168]

Oil and gas taxes clearly infringe upon tribes' ability to self-govern. The state taxes make it difficult for the tribes to fund essential services, such as

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159. *See id.*

160. Tanana & Ruple, *supra* note 8, at 15.

161. EagleWoman, *supra* note 12, at 72.

162. Cowan, *supra* note 15, at 110.

163. *Id.* (quoting Williams v. Lee, 358 U.S. 217, 220 (1959)).

164. *Id.*

165. *Williams*, 358 U.S. at 217-18 (ruling on action brought by a non-Indian operating a general store on the Navajo Indian Reservation against a Navajo Indian and his wife to collect for goods sold to them at his store on credit).

166. *Id.* at 222-23.

167. *Id.* at 223.

168. New Mexico v. Mescalero Apache Tribe, 462 U.S. 324, 338 (1983).

providing for the health and welfare of their members, because the state's taxes decrease the ability of tribes to impose their own taxes and consequently decrease tribes' tax revenues.[169] Additionally, tribal funds are used to provide oil and gas services, further reducing the amount of money available to provide essential services to the tribes.[170]

B. Decreasing Attractiveness of Leasing on Indian Lands

The taxation quagmire created by the imposition of so many levels of taxation further discourages businesses from engaging in business on tribal lands.[171] Due to problems such as the lack of infrastructure and the complex and confusing application of commercial laws, businesses are often already hesitant to operate on Indian lands.[172] The possibility of being taxed by both the tribe and the state makes operating on tribal lands even less appealing.[173] For instance, businesses will receive a lower rate of return when doing business on-reservation than they will off-reservation, where they are subject to only state and federal taxation.[174] Many utility companies continue to operate on Indian lands and avoid this problem by passing the increased cost off to their customers.[175] However, the demands of producers and the high competition within the industry are making this pass-off more and more difficult.[176]

Even the Court in *Cotton* acknowledged that the imposition of state taxation decreases the profitability of oil and gas leases taken on Indian lands.[177] However, that Court concluded that state taxation similarly reduces the profitability of off-reservation leases.[178] Following its own precedent, that Court further concluded that the indirect burden on the tribe caused by the state taxes was insufficient to immunize on-reservation non-Indian leases from those taxes.[179] As explained in this note, that conclusion was incorrect.

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169. Fredericks, *supra* note 35, at 64.
170. *Id.*
171. Cowan, *supra* note 15, at 95.
172. *Id.*
173. *Id.*
174. Tanana & Ruple, *supra* note 8, at 19-20.
175. *Id.* at 20.
176. Fredericks, *supra* note 35, at 64.
177. *Id.*
178. *See* Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 191 (1989).
179. *Id.*

C. Deplorable Economic Conditions on Reservations

Extreme poverty and other deplorable economic conditions are common on most Indian reservations.[180] In November 2011, for example, the median income of American Indian and Alaska Native households was $35,062, compared with a national average of $50,046.[181] Additionally, the American Indian and Alaska Native poverty rate at that time was 28.4%, versus 15.3% for the nation as a whole.[182] Twenty-two percent of Indians live on reservations, where there are often much worse—living conditions than those in third world countries.[183] The number of Indians living below the poverty line increases dramatically on-reservation, from 28.4% to at least 38% and even up to 63%.[184]

The double taxation problem significantly contributes to these problems.[185] The elimination of state taxes would help bring the tribes into positions where they can "rebuild economically and independently their communities and provide for the health and welfare of tribal members."[186] This is particularly true with regard to oil and gas operations. Oil and gas are often the only inherent sources of wealth on Indian lands.[187] In fact, the first efforts to allow state taxation of activities of non-Indians on Indian lands stemmed from the identification of oil and gas under those lands.[188] Thus, because the authority of tribes to impose taxes on these activities has not been questioned, the decision to allow state taxes gave birth to the issue of double taxation.[189]

While the imposition of state taxes in some areas may actually benefit tribes by encouraging them to start their own businesses, which would be exempt from state taxes, this is just one example of why state taxes might undeservedly deter tribes from contracting with nonmembers to do business. While tribal businesses spur tribal economic development and

180. Comment, *supra* note 131, at 491.

181. *American Indian and Alaska Native Heritage Month: November 2011*, U.S. CENSUS BUREAU FACTS FOR FEATURES (Nov. 1, 2011), http://www.census.gov/newsroom/releases/archives/facts_for_features_special_editions/cb11-ff22.html.

182. *Id.*

183. *See id.*; *Living Conditions*, NATIVE AMERICAN AID, http://www.nrcprograms.org/site/PageServer?pagename=naa_livingconditions (last visited Jan. 10, 2014).

184. *Living Conditions*, *supra* note 183.

185. Cowan, *supra* note 15, at 96.

186. EagleWoman, *supra* note 12, at 72.

187. Cowan, *supra* note 15, at 121.

188. EagleWoman, *supra* note 12, at 55.

189. *Id.* at 56.

enhance tribal self-government, helping to further both goals of the 1934 IRA,[190] this is not a practical solution in the field of natural resource operations. Because particular expertise and equipment is needed to efficiently extract and manage minerals, it would be almost impossible for tribes to simply start their own production operations, at least in the short term. Thus, tribes are forced to either deal with nonmembers in this area or choose not to develop their natural resources, foregoing the potential profits from production and risking waste of the precious resources.

D. An Issue of Nationwide Importance

Cases such as *Rodriguez* and *Cotton* do not just affect the tribes and states involved in the cases. They affect all tribes with oil and gas reserves on their reservations, and all states in which those reserves are located.[191] Both states and tribes want to receive as much tax revenue as possible from oil and gas severance taxes.[192] Also, because of the specialized knowledge and infrastructure required in the production of oil and gas, tribes often have no choice but to engage in business with nonmembers in this field, inexorably implicating the double taxation issue. Additionally, while cases involving Indian affairs may not appear to have widespread ramifications, "the growing importance of commercial ventures on Indian reservations (e.g., casinos, hotels, mineral rights) and their effect on the state and local tax base add significance to such disputes" for all taxing jurisdictions and taxpayers, not just tribes and their members.[193]

VI. Solutions

The easiest way to solve the problems and inconsistencies of double taxation is through legislation by Congress. First, Congress could explicitly preempt (or allow) state taxes on oil and gas production by non-Indians on Indian lands, either in full or in part. Second, Congress could provide tax incentives to encourage tribes and states to work together to resolve tax issues among themselves.[194] Congress could also provide tax incentives in the form of tax credits specifically designed to alleviate this problem.

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190. Cowan, *supra* note 15, at 119-120.

191. Stewart P. Ralphs, *Taxation of Non-Indian Mineral Leases on Tribal Lands: Validity of Both Tribe and State Severance Taxes?*, 11 J. ENERGY NAT. RESOURCES & ENVTL. L. 127, 140 (1990).

192. *Id.*

193. Boehl & Mahon, *supra* note 97, at 45.

194. Cowan, *supra* note 15, at 97.

In lieu of specific tax legislation, the federal government could step in to help with the enactment of tax compacts between states and tribes. Compacts are agreements between tribes and states in which the two parties decide to levy one overall tax and divide the proceeds between themselves. However, due to unequal bargaining power between the two parties, tribes often give away a large part of the tax revenues in order to avoid conflict and litigation.[195] A better bargaining process could increase the use and success of tax compacts as well as work towards solving the double taxation problem.

VII. Conclusion

The reasons for preempting state taxation of on-reservation non-Indian oil and gas operations are numerous and, from a policy standpoint, help to increase both the value of the leases and the economic development of Indian tribes. As a matter of law, such taxes should be examined on a case-by-case basis. While *Cotton* was correctly decided, its application is far from universal. The facts in *Rodriguez* are much more favorable to the tribe. When the state has legitimate interests and the economic burden of the taxes fall on the tribe, courts should apply a proportionality analysis in addition to the traditional *Bracker* Balancing Test, weighing not just the level of interest of each party but also the specific burdens and benefits of the taxes on the parties. Additionally, courts should frame the question in terms of whether the state taxes are authorized, not whether they are preempted. These changes to the traditional test will help increase the fairness in oil and gas leases between tribal and non-tribal members as well as promote better cooperation and interaction between all parties involved in such transactions.

195. Sullivan, *supra* note 9, at 851.