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THE RETURN OF THE WHITE BUFFALO: TAXATION ISSUES FACING AMERICAN INDIAN TRIBES CONDUCTING GAMBLING ENTERPRISES ON TRIBAL LANDS

Jose J. Monsivais*

I. Introduction

Approximately one million American Indians live on reservations in the United States.¹ The responsibility for the overseeing and administering these reservations lies with the federal government through the Bureau of Indian Affairs, an arm of the Department of the Interior. This group of Americans is extremely dependent on the federal government for support, and cuts in Indian appropriations by Congress have a tremendous effect. It has been estimated that during the Carter administration,² Indian appropriations made up .04% of the federal budget. In 1982, however, 2.5% of all federal budget cuts came entirely from Indian appropriations.³ Coupled with an unemployment rate of 16.2% compared to the national rate of 6.4%, and a poverty rate of 31.7% compared to the national rate of 13.1%, tribal leaders have had to search for ways to support their people.⁴

Many tribes have turned to leasing reservation lands to oil, mineral, and energy companies for their use and exploration. Such efforts have helped to contribute to economic survival. Some tribes, however, have found themselves living near strip mines and toxic waste dumps.⁵

Other tribes have turned to gambling in order to survive. Many Indians today have described Indian gaming as "the return of the white buffalo."⁶ Some American Indians believe that when a white buffalo is sighted, good fortune will follow and enemies will stay away. After many years of despair,

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1. Michael Satchell et al., *The Worst Federal Agency*, U.S. NEWS & WORLD REP., Nov. 28, 1994, at 61, 62.

2. James Earl Carter, Jr. was the 39th President of the United States and served from 1977 to 1981.

3. DAVID H. THOMAS ET AL., *THE NATIVE AMERICANS: AN ILLUSTRATED HISTORY* 444 (1993).

4. See Satchell, *supra* note 1.

5. THOMAS, *supra* note 3, at 444, 445.

6. Heidi McNeil, *Indian Gaming- Prosperity, Controversy*, in *THE GAMING INDUSTRY ON AMERICAN INDIAN LANDS* 139 (PLI Corporate Law & Practice Course Handbook Series No. 872, 1994) [hereinafter *GAMING INDUSTRY*].

and the taking away of every means of self-sufficiency by the settling Europeans, gambling has emerged as a blessing of sorts. More than 120 tribes today have gambling enterprises on their reservations, and this has contributed to substantial economic growth and reduced levels of unemployment.⁷

II. Current Status Under Federal Law

Until the federal government chooses to extinguish their title, the majority of Indian lands on the reservations will be held in trust by the United States for the occupancy of Indian people.⁸ Because of this trust status, state laws generally have no force on these lands.⁹

Many tribes took advantage of this trust status to bypass state gaming laws and began gambling enterprises on reservation lands.¹⁰ In *California v. Cabazon Band of Mission Indians*,¹¹ the United States Supreme Court held that tribes could have gambling on their reservations as long as gambling was allowed in the state. *Cabazon* involved bingo and poker games held entirely on Indian reservations. California sought to impose its restrictive gambling laws upon the tribes in an effort to prevent any increase in organized crime. The Supreme Court held that while state laws are not, per se, invalid on Indian reservations, they must not conflict with federal law and policy. The Court found the reservation gambling consistent with Congress' policy favoring tribal self-development. Furthermore, California's interest in halting organized crime was insufficient to trump federal and tribal interests. The federal government was free to prohibit gambling if it so desired and likewise could take action to stop organized crime.¹²

Although California's laws were "criminal laws," they amounted to impermissible state regulation. As long as any federal regulatory scheme existed, or sufficient tribal interests were present, states could not regulate tribal gambling. However, if a state prohibited gambling within its borders, reservations would have to comply, unless granted permission by the state.

In response to this perceived loss of rights, many states protested the inability to regulate the gambling enterprises within their borders.¹³ Congress accordingly passed the Indian Gaming Regulatory Act of 1988 to address the issue concerning regulation of tribal gambling.¹⁴

7. *Id.*

8. *See Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 14 (1831).

9. *See Worcester v. Georgia*, 31 U.S. (6 Pet.) 515, 590 (1832).

10. THOMAS, *supra* note 3, at 451.

11. 480 U.S. 202, 213 (1987).

12. *Id.* at 221.

13. Arizona and Connecticut vigorously protested the lack of sufficient state control over reservation gambling enterprises within their borders.

14. 25 U.S.C.A. §§ 2701-2721 (West Supp. 1995).

The conflict between tribes, states, and private gaming interests is far from settled. Many issues explored in this paper will, inevitably, undergo some revision over time. States desire more control over tribes, and tribes refuse to concede any more hard fought rights, so the struggle continues.

Indian law is a collection of ever-changing laws meant to carry out the policies of the day in our nation's capital. Tax law is no different, and Indian tribes' taxation is unique in several areas compared to non-Indians. In addition, states are eager to increase revenues and have gained ground in the taxation of tribal members and nonmembers on Indian reservations. This paper will focus on the income tax and related tax issues facing the gaming industry on American Indian lands. Many of the issues dealt with can be answered in individual tribal situations by examining treaties entered into with the United States. There have been over 800 treaties entered into by the United States and Indian tribal governments.¹⁵ Income tax issues may be dependent on rights given in treaties, but a detailed discussion on each treaty is beyond the scope of this paper. This author will deal primarily with taxation issues which affect tribes and their members who conduct gambling enterprises in the absence of treaty considerations.

III. Federal Income Taxation

A. Tribal Governments

Generally, the Internal Revenue Code (IRC) exempts the income of Indian nations, or tribal governments from federal income taxation.¹⁶ The Code treats the tribes as states for income tax purposes. In order to qualify for the exemption, tribes must be federally recognized. A discussion on the differences between state and federal recognition of Indian tribes is beyond the scope of this paper, but suffice to say non-federally recognized tribes are not within the exemption granted. This treatment is rooted in sovereignty principles long recognized by the federal government, which treats tribes as unique aggregations like no other entities.¹⁷ Tribes are allowed wide latitude in their internal affairs, much like a separate and distinct political entity. Unless Congress specifically limits their sovereignty, they retain it.¹⁸

This tax exemption is broad. It applies irrespective of where the income is earned, and this principle was reaffirmed in a recent revenue ruling.¹⁹ If a tribe, however, chooses to do business under a corporate charter, the rules may change, and all available options concerning the specific details of

15. Chris Griesel et al., *Indian Law is Nothing to Gamble On*, 58 TEX. B.J. 358, 359 (1995).

16. I.R.C. § 7871 (1994).

17. *United States v. Mazurie*, 419 U.S. 544, 556-57 (1975).

18. *Iron Crow v. Oglala Sioux Tribe*, 231 F.2d 89, 98 (8th Cir. 1956).

19. Eric Facer, *Federal Income Tax Issues Confronting Indian Gaming Operations*, in GAMING INDUSTRY, *supra* note 6, at 210 (citing Rev. Rul. 94-16, 1994-1 C.B. 19).

incorporation should be examined. Even if a tribe owns the corporation, it may be subject to the federal income tax.²⁰ These issues will be discussed in the next section.

B. Federal Policies

In 1934, Congress passed the Indian Reorganization Act.²¹ This Act was meant to encourage economic development and business pursuits by tribal governments. Section 17 of the Act provided a framework for tribes to incorporate their businesses along the lines of modern business corporations.²² Consistent with this Congressional policy, the Internal Revenue Service (IRS) exempted these corporations from the federal income tax.²³ The service cited *Mescalero Apache Tribe v. Jones*,²⁴ for the proposition that the tax exemption for activities on the reservation does not depend on the form of business chosen. This idea was confirmed in Private Letter Ruling 88-03-013²⁵ to extend the tax exemption to state-chartered, tribally owned, corporations. In order to qualify for benefits from the Small Business Administration, the Pueblo Tribe chose to incorporate under state law instead of section 17. The IRS reasoned that there should be no difference between the two forms of incorporation for purposes of the federal tax exemption.

This had been the IRS's position until Revenue Ruling 94-16²⁶ was issued. Revenue Ruling 94-16 removed the federal tax exemption from state-chartered corporations wholly owned by Indian Tribes. The ruling further provided that this income would be taxable even if earned on the reservation. The IRS reasoned that *Mescalero Apache Tribe v. Jones* did not control because state-chartered corporations do not share the same tax status as unincorporated businesses, or section 17 corporations.

Revenue Ruling 94-16 provides very little reasoning for the IRS's ultimate decision, but several arguments could be advanced. The strongest is probably the policy behind the Indian Reorganization Act; namely, to provide federal assistance for the establishment of tribal businesses. Once a tribe decides not to use the assistance provided by the federal government, it arguably falls under the rule of section 7871 of the IRC, which only exempts federally recognized tribes. Although a tribe may still be federally recognized, by operating under a state charter, the IRS has decided to characterize it as a change in tax status. Another reason may be that section 17 corporations are

20. *Id.* at 210.

21. 25 U.S.C.A. §§ 461-479 (West 1983 & Supp. 1995).

22. 25 U.S.C.A. § 477 (West Supp. 1995); Priv. Ltr. Rul. 88-03-013 (Oct. 19, 1987).

23. Rev. Rul. 81-295, 1981-2 C.B. 15.

24. 411 U.S. 145, 155 (1973).

25. Priv. Ltr. Rul. 88-03-013 (Oct. 19, 1987).

26. Rev. Rul. 94-16, 1994-1 C.B. 19.

subject to the oversight of the Bureau of Indian Affairs in their business dealings, and state-chartered corporations are not.²⁷ The IRS may be substituting federal income taxes for federal regulation, and each tribe must evaluate for itself which one it prefers.

In contrast, a tribe may choose to incorporate under tribal law. For purposes of federal income taxes, these corporations are currently exempt. However, it is reported the IRS is contemplating a reversal of this position.²⁸ For the time being, should a tribe proceed in a gambling enterprise in joint venture or partnership form with either Indians or non-Indians, the interest owned by the tribe is free from federal income taxes.²⁹

C. Tribal Members

When the United States Constitution was written, American Indians were not citizens, nor subject to ordinary state and federal legislation.³⁰ American Indians were referred to only twice in the Constitution and were for the most part ignored as a political body.³¹ As a consequence, the "Indians not taxed" phrase of the Constitution meant what it said for the era in which it was written.³² Although at first glance it appears to be a tax exemption for American Indians, the purpose was to describe and further identify this group of Native Americans which would not be counted for purposes of representation in Washington. This seemingly blanket clause has been closely scrutinized and interpreted very narrowly by the courts today. Indians, by virtue of being Indians, are not exempt from federal taxes.³³ This is true even if their income was earned in "Indian Country."³⁴ Some courts have even held that the constitutional phrase was merely descriptive and did not

27. Facer, *supra* note 19, at 210.

28. *Id.* at 213.

29. *Id.* at 214.

30. See FELIX S. COHEN'S HANDBOOK OF FEDERAL INDIAN LAW 388 (Rennard Strickland et al. eds., 1982) [hereinafter COHEN].

31. U.S. CONST. art. I, § 2, cl. 3 (dealing with representation of the states); U.S. CONST. art. I, § 8, cl. 3 (dealing with commerce) ("To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes").

32. U.S. CONST. art. I, § 2, cl. 3. The clause states:

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding *Indians not taxed*

Id. (emphasis added).

33. Superintendent of Five Civilized Tribes v. Commissioner, 295 U.S. 418 (1935).

34. See 18 U.S.C.A. § 1151 (West 1983 & Supp. 1995). The section states that "Indian country" includes all lands granted by and under the jurisdiction of the United States to the tribes, without regard to state borders, and all land allotments. *Id.* "Indian country" is not limited to a reservation's boundaries. *Id.*

restrain the federal government from taxing Indians.³⁵ The phrase has also been held to restrain only the taxing power of the states.³⁶ Lastly, the United States Supreme Court has held that in order for an Indian to be exempt from the federal income tax, a specific exemption must either be created by Congress or found in the language of a treaty. The exemption does not exist by negative implication.³⁷

What income is then exempt from the federal income tax? Congress has elected not to tax income which flows, or "derives directly" from lands held in trust by the United States for use by Indians. The granting of land by the United States to American Indians was done through the General Allotment Act of 1887,³⁸ and other acts. The General Allotment Act conveyed land allotments to many Indians free from any encumbrances after being held in trust by the United States for a term of years.³⁹ However, the United States Supreme Court held all income which is "derived directly" from the allotted land only while it remains in trust is exempt from federal income taxes.⁴⁰ This holding has been interpreted in many ways with no concrete test given by the Supreme Court. As a result, lower courts must resolve conflicts on a case by case basis to determine the outcome.

1. The Interpretation and Application of Squire v. Capoeman

If an Indian derives income directly from lands held in trust, and the lands are used by the tribe as a whole, the exemption is lost.⁴¹ This is because no individual Indian has title or an enforceable right in tribal property.

Another curious example concerns income which is earned by an Indian on allotted lands leased to him. The IRS has also denied the exemption in this situation.⁴² From the language of the General Allotment Act, one gets the impression the relevance lies in the status of the land itself. However, the two examples above show that the IRS was more concerned with who carried the benefit and burdens of the land and placed great emphasis on the person or entity which owned the land, versus the trust status. The IRS's position on

35. *Lazore v. Commissioner*, 11 F.3d 1180 (3rd Cir. 1993).

36. *Jourdain v. Commissioner*, 71 T.C. 980 (1979), *aff'd*, 617 F.2d 507 (8th Cir. 1980), *cert. denied*, 449 U.S. 839 (1980).

37. *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 156 (1973).

38. 25 U.S.C. §§ 331-334, 339, 341, 342, 348, 349, 354, 381 (1994) (Dawes Act). Although other congressional acts were passed for the purpose of granting land allotments to Indians, the General Allotment Act's terms are generally followed by subsequent acts.

39. 25 U.S.C. § 348 (1994) ("[T]he United States will convey the same by patent to said Indian, . . . in fee, discharged of said trust and free of all charge or incumbrance whatsoever . . .").

40. *Squire v. Capoeman*, 351 U.S. 1 (1956).

41. *Holt v. Commissioner*, 364 F.2d 38, 41 (8th Cir. 1966), *cert. denied*, 386 U.S. 931 (1967).

42. *Id.*

leased land was sustained by the Eighth Circuit in *Holt v. Commissioner*.⁴³ The court reasoned that because the lessee had no vested interest in the land, the tax could not possibly encumber his property. The result reached turned on protection solely of a property right. In connection with the reasoning applied by the Supreme Court in *Squire v. Capoeman*,⁴⁴ the IRS has exempted rents and royalties from federal income taxation.⁴⁵ This includes income from the land and resources attached to the land.

2. Sale of Livestock and the "Derived Directly" Test

If an Indian sells livestock for a gain, after raising and grazing the livestock on trust land, such gain is not taxable.⁴⁶ In that situation, one can see that the livestock are not attached to the land, so the gain is not "derived directly" from the land, but through the sale. The inputs to create better livestock come not from the land, but from labor and better grain and living conditions for the livestock through capital improvements. Nevertheless, this income is not taxable.

However, if an Indian operates a business such as a motel or smokeshop, on the reservation, income from such operation is fully taxable by the federal government.⁴⁷ The reasons given by the courts are, interestingly enough, that the income is derived from labor and capital improvements to the land. As such, this income is not "derived directly" from the land, and not exempt. The United States Supreme Court has stated that in "derived directly" situations, once the asset is removed, the land is of little value, such as in the case of the sale of timber.⁴⁸ In other words, the value of the land lies in the removable resources. In the case of retail establishments, the income is derived from the sale of goods and services. As those products and services are sold, the land is not affected and does not lose its value. Following this line of reasoning may lead one to wonder why the gains from the sale of livestock are not also taxable. After all, as livestock are sold, the land is not affected and also loses no value.

3. Reinvestment of Proceeds

If the proceeds from tax-exempt lands are reinvested, the reinvestment income is fully taxable. Only, if it can be shown that the reinvestment income is derived directly from the trust land is it exempt from federal income taxation.⁴⁹

43. *Id.*

44. 351 U.S. 1 (1956).

45. Rev. Rul. 56-342, 1956-2 C.B. 20.

46. Rev. Rul. 62-16, 1962-1 C.B. 7.

47. *Critzer v. United States*, 597 F.2d 708 (Ct. Cl. 1979), *cert. denied*, 444 U.S. 920 (1979); *Dillon v. United States*, 792 F.2d 849 (9th Cir. 1986), *cert. denied*, 480 U.S. 930 (1987).

48. See *Squire v. Capoeman*, 351 U.S. 1, 10 (1956).

49. *Id.* at 9.

4. *The Taxation of Tribal Distributions to Members*

A tribe receiving income from any source may make general welfare payments to its members. As long as these payments are made on the basis of specific need, they are not taxable to the recipient.⁵⁰ This has been the IRS's position in the past with regard to welfare payments provided by the government,⁵¹ and has been extended to include welfare benefits provided by the tribe. The Bureau of Indian Affairs has interpreted this exemption to include housing subsidies, scholarships and payments for medical assistance.⁵²

When a tribe conducts a gambling enterprise and distributes profits to its members, on a per capita basis, those profit distributions are fully taxable to the recipient.⁵³ In the past tribes were not required to withhold taxes from distribution of gambling profits to its members. In 1994, however, Congress amended the IRC, and tribes are now required to withhold taxes on those payments made to tribal members after January 1, 1995.⁵⁴ Members receive an IRS Form 1099 from the tribe verifying the payments. Taxable distributions include those received in cash, services, or property by the tribal members.⁵⁵

A tribe may create a trust for an individual member and hold any amounts for their benefit in trust. When such amounts are held by the tribe, they are not taxable to the individual member. Any income earned by the trust is not taxable to the tribe or the member while it is in trust.⁵⁶ Only when monies are actually distributed, or the member has a right to receive them, do they become taxable to the member.

One can see the potential problems with the categorization of distributions by the tribe to its members. The income here is dependent on what label is placed on the money being distributed. Gambling profits are fully taxable to the member, but general welfare benefits also distributed by the tribe are not. However, there is no requirement that the monies distributed as general welfare benefits be derived from any particular source. There is no requirement that a tribe making distributions to members on a reservation with gaming operations, label them "profits" versus "welfare payments." If monies are intermingled or a specific need is shown for each member, these distributions may escape income taxation altogether. This is not to say that this situation will be abused by the tribes, but is discussed only to illustrate

50. See Facer, *supra* note 19, at 216-17 (citing 25 U.S.C. § 2710(b)(2)(B)).

51. See Rev. Rul. 78-170, 1978-1 C.B. 24; Rev. Rul. 74-74, 1974-1 C.B. 18.

52. See Facer, *supra* note 19, at 217-18.

53. *Id.* at 215 (stating that per capita distribution means any amount paid to a tribal member based solely on tribal membership).

54. 26 U.S.C.A. § 3402(r) (West Supp. 1996).

55. See Facer, *supra* note 19, at 215.

56. *Id.*

the state of the law. The IRS may believe potential for abuse exists, but, one could argue that such lenient treatment is necessary to effectively carry out Congress' policy of promoting tribal self-sufficiency. With the high levels of poverty present on the reservations, specific need does not seem hard to prove. Whatever the case may be, conflicts are sure to arise as stringent application of the rules will be sought by the IRS in a somewhat gray area.

D. Other Related Federal Taxes

Like non-Indian employers, tribes, in their capacity as employers, are not exempt from payroll taxes.⁵⁷ Since states and other governmental entities are subject to this rule as well, exemption from these laws for tribes would be difficult to argue on traditional sovereignty or other established principles against application of the rule. As a consequence, tribes are complying with these laws, and no controversies seem to have arisen.⁵⁸ There is an exemption, however, for payments to tribal officials performing official duties for the tribe.⁵⁹ This rule may have been developed along sovereignty lines, treating tribe officials as "public" officials. Although not clear in its applicability to tribal officials, the Internal Revenue Code exempts fees paid to public officials from the withholding laws.⁶⁰

E. Wagering Taxes

The Internal Revenue Code imposes an excise tax of 0.25% on wagers accepted by a person on behalf of another.⁶¹ "Wager" is defined as a wager with respect to a sporting event or contest, or any wager placed in a wagering pool with respect to a sporting event or contest, or any wager placed in a lottery.⁶² "Lottery" in this situation applies only to a numbers game and similar types of lotteries which do not encompass the ordinary state lotteries.

The Code also imposes an occupation tax of \$500 a year on each person liable for the tax imposed under section 4401.⁶³ Further, there is also a provision reducing the tax from \$500 to \$50 in certain situations.⁶⁴ The relevant inquiry in this situation would be to ascertain whether these taxes apply at all to the Indian tribal governments operating gaming facilities. After

57. See I.R.C. § 3401(a) (1994); Rev. Rul. 59-352, 1959-2 C.B. 24.

58. See COHEN, *supra* note 30, at 399.

59. Rev. Rul. 59-354, 1959-2 C.B. 24. The ruling states that although includable in gross income under § 61 of the Internal Revenue Code, amounts paid to members of Indian tribal councils for services performed by them do not constitute wages for the purpose of the Federal Insurance Contributions Act, Federal Unemployment Tax Act, and the collection of income tax at source on wages. *Id.*

60. I.R.C. § 3401(a) (1994).

61. *Id.* § 4401(a)(1).

62. *Id.* § 4421.

63. *Id.* § 4411(a).

64. *Id.* § 4411(b).

all, under section 7871 of the IRC, tribal governments are exempt from certain federal taxes, and these wagering taxes are a gross receipts tax.

This question was answered by the IRS in Private Letter Ruling 92-29-005⁶⁵ and later in Revenue Ruling 94-81.⁶⁶ The taxpayer, an Indian tribal government, owned a bingo palace and casino. As part of its operation, the tribe sold pull-tabs, which is essentially a form of a punchboard.⁶⁷ The tribe also conducted a drawing related to its bingo operation. With the purchase of a bingo package, a customer received a registration card which, when filled out and dropped in a barrel, entitled them to be eligible for a prize drawing. The IRS reasoned that the prize drawing which was part of the bingo operation was a taxable "lottery" under I.R.C. § 4421. Because a winner in the drawing had to be present to receive a prize, the IRS determined that prizes were not distributed in the presence of all persons placing wagers in the game, which was required under I.R.C. § 4421(2)(A)(iii), in order to be exempt from the wagering tax. That the wagering tax applied to the sale of pull-tabs and wagers placed on this type of "lottery," when conducted by a casino not tribally owned, was not disputed. The only contested issue was whether the wagering tax applied to these activities when carried out by a tribally owned bingo palace and casino.

The tribe raised several arguments dealing with specific exemptions. First, it argued that under section 7871, tribes are exempt from federal taxes. Secondly, section 7871 provides for the treatment of tribal governments as states. This tax would treat tribal governments differently than it would treat states, and this is not allowed. The IRS countered that only the specifically enumerated excise tax exemptions are granted, and the wagering tax is not on the list. Therefore, this tax is outside the realm of the exemption and is valid. Section 7871 encompasses federal income taxation and other enumerated taxes, and this tax is not included.

As for the differential treatment, the IRS raised two points. First, it stated that the exemption protected transactions only if the transaction involved the exercise of an essential governmental function of the Indian tribe.⁶⁸ These functions would include ones associated with the operation of a governmental entity. If the absence of these functions would cause difficulties for the governmental entity, then they would most likely be essential. The IRS then reasoned that gaming operations are not essential functions of a government or political subdivision. As such, the exemption does not protect tribal governments when they act outside of their essential functions.

With an unemployment rate of more than twice that of the rest of the country, one could argue that tribal governments are indeed performing an

65. Priv. Ltr. Rul. 92-29-005 (July 17, 1992).

66. Rev. Rul. 94-81, 1994-2 C.B. 412.

67. See Rev. Rul. 57-258, 1957-1 C.B. 418.

68. I.R.C. § 7871 (b) (1994).

essential function in employing tribal members. The tribes are also seeking to improve living conditions and a host of social problems, as well as alleviate the overwhelming levels of poverty on the reservations through the economic growth and development provided by gambling. Furthermore, the tribes are arguably fulfilling their duties as a sovereign in resolving these problems for their members through the best, and sometimes only, means available to them.

Next, the tribe argued that the Indian Gaming Regulatory Act provided an exemption.⁶⁹ This section provides that tribes are exempted, to the same degree as states, from reporting and withholding requirements on winnings from gaming or wagering operations. The tribe argued that this exemption flows from the wagering tax exemption provided to states. Since states have no wagering taxes imposed on lotteries, sweepstakes, and wagering pools, they of course do not have to report winnings. After all, without the tax, the reporting and withholding requirements are meaningless. The tribe interpreted this as saying that tribes should not have reporting or withholding requirements, and should be exempt from the wagering tax as the states are, since section 7871 of the IRC says tribes shall be treated in the same manner as the states.

The IRS responded by illustrating that states do not receive a blanket exemption from wagering taxes under section 4402(3) of the IRC, but a limited one. The IRS interpreted this section as applying only to the specific types of wagers included in the Code. These are sweepstakes, wagering pools, or a lottery. Also, the exemption applies only if it is conducted by specified state agencies. Therefore, the service concluded that tribes and states are treated the same. If a state conducts a wager outside of their specified exemptions, the IRS continued, wagering taxes are imposed.

The tribe further argued that section 2719 of the Gaming Act was ambiguous, and should be resolved in favor of the tribe. The United States Supreme Court has held that statutes passed for the benefit of Indian tribes are to be liberally construed, with doubtful expressions being resolved in favor of the Indians.⁷⁰ Since the language did not clearly treat tribes and states in the same manner, it should be applied favorably to the tribe.

The IRS pointed to the legislative history of the Gaming Act.⁷¹ The IRS illustrated that section 2719(d), as originally introduced, specifically stated that "provisions of the Internal Revenue Code of 1986, concerning the *taxation*

69. See 25 U.S.C.A. § 2719(d) (West Supp. 1995). The section states:

The provisions of the Internal Revenue Code of 1986 . . . concerning the reporting and withholding of taxes with respect to the winnings from gaming or wagering operations shall apply to Indian gaming operations conducted pursuant to this chapter, . . . in the same manner as such provisions apply to State gaming and wagering operations.

Id.

70. *Three Affiliated Tribes v. Wold Eng'g*, 467 U.S. 138 (1984).

71. See S. REP. NO. 446, 100th Cong., 2d Sess. (1988).

and the reporting and withholding of taxes with respect to the winnings from gaming or wagering operations shall apply to Indian gaming operations . . . in the same manner as such provisions apply to State gaming,"⁷² and the statute as enacted deleted "taxation" from the language. The IRS contended that this removes any ambiguity from the statute. If Congress wanted to include wagering in its list of tax-exempt activities on Indian lands, it could have left the statute alone. Instead, Congress intended to exclude tribes from this exemption and meant to apply the same treatment it applies to states only in reporting and withholding requirements. Since the IRS determined that the tribe was not exempt from wagering taxes, the occupational tax of section 4411 applied as well.

F. Payment of Winnings by a Tribe

1. Withholding

Under section 3402(q) of the IRC, a tribe would be subject to the withholding rules. Withholding of 20% of winnings is required if the amount of the payout exceeds \$5000 and the amount is at least 300 times as large as the amount wagered. Tribes are treated in the same manner as the states for withholding purposes.

2. Reporting

Tribes are also required to report certain winnings on IRS Form W-2G, and an annual report on IRS Form 945.⁷³ If a person wins \$1200 or more from a bingo or a slot machine, reporting is required. Additionally, if a person wins \$1500 or more from keno or wins \$600 or more from wagering transactions and either of those amounts equals or exceeds 300 times the amount wagered, reporting is required.

Once the tribes were specifically included in section 2719(d) of the Gaming Act, with regard to the reporting and withholding requirements, no conflicts have arisen. The main source of contention between the tribes and the federal government lies in the area of wagering taxes, which tribes believe they should be exempt from paying.

IV. State Taxation

A. Introduction

An in-depth study of state taxation of tribes and tribal members involves examining federal preemption, sovereignty, and jurisdictional issues. States have sought to regulate and tax Indians on the various reservations for many years. Generally, such efforts have been unsuccessful, but in some

72. S. 555, 100th Cong., 1st Sess. § 20(d) (1987).

73. See Facer, *supra* note 19, at 222.

circumstances, states have been granted limited powers of taxation and regulation over tribes. States are dependent on the federal government for their powers over federally recognized tribes and their members, and without federal approval have no jurisdiction in most cases.

Since the cases allowing state taxation are limited in scope, they require careful examination to determine their applicability in the gambling area. From the days of *Worcester v. Georgia*,⁷⁴ "the policy of leaving Indians free from state jurisdiction and control is deeply rooted in the Nation's history."⁷⁵ This is somewhat misleading, as the United States Supreme Court has held that the term "Indian" means only an enrolled member within the bounds of their own reservation, in certain situations.⁷⁶ This point will become relevant in later discussion.

State power to tax is found by looking to sovereignty and federal preemption principles. In modern times, however, the courts are relying less on sovereignty and more on federal preemption to resolve conflicts between the tribes and states. Some commentators have also pointed out that Indian tribal sovereignty may be a dead issue,⁷⁷ as the Supreme Court relies more and more on federal preemption. Nevertheless, the law in this area is dynamic and a look at both areas is necessary to develop a meaningful analysis.

B. Sovereignty

*Williams v. Lee*⁷⁸ involved a suit by a non-Indian store owner operating on the Navajo reservation against two Navajo Indians for collection of money due for goods sold on credit. The suit originated in the Superior Court of Arizona. The Navajo Indians argued that jurisdiction was proper in the tribal courts of the Navajo reservation, but, the Arizona court disagreed and entered judgment for the store owner. The case was appealed, and the Arizona Supreme Court affirmed, holding that since no act of Congress forbade the state courts from hearing cases by non-Indians against Indians, jurisdiction was proper in the state courts. The next stop was the United States Supreme Court.

Williams is especially relevant in the taxing area, because, although seemingly unrelated, the principles enunciated by the Supreme Court mark the beginning of an analysis dealing with state powers over the reservations within the states' boundaries. The Court quickly disposed of the state's argument that since the respondent was not an Indian the state courts had jurisdiction. The Court reasoned that this fact was immaterial and the true

74. 31 U.S. (6 Pet.) 515 (1832).

75. *Rice v. Olson*, 324 U.S. 786, 789 (1945).

76. *United States v. Antelope*, 430 U.S. 641 (1977).

77. See Daniel Rotenberg, *American Indian Tribal Death — A Centennial Remembrance*, 41 U. MIAMI L. REV. 409 (1986).

78. 358 U.S. 217 (1959).

nature of Arizona's transgressions harmed the tribe more than any notion, advanced by the state, of protecting its citizens.

The state had attempted to usurp the powers of the tribal courts, and had impermissibly attempted to regulate the affairs of the tribal government. The Navajo Tribe deserved great respect, as it had greatly improved its system of government and legal system. The Court then stated that this was consistent with the federal government's policy of promoting self-government and self-sufficiency of the tribes. Arizona's attempted acts would in effect halt this progress and substitute its own judgment for that of Congress. The Court declared that "if this power is to be taken away from them, it is for Congress to do it," referencing the tribe's power of self-government.⁷⁹

This case outlined the fundamental sovereignty principles to be relied upon in this area. It seemed to place the tribes and states on the same level. The states then appear to be in a situation in which they may have no control over what occurs within their boundaries. It should be emphasized though, that the burden of Arizona's actions fell upon the tribe and tribal members. When non-Indians are the ones subject to the states' acts and the tribe appears not to be affected, the result may be different.

In *New Mexico v. Mescalero Apache Tribe*,⁸⁰ the state sought to apply its hunting and fishing laws to nonmembers on the reservation. The state argued that its regulations would not interfere with the tribe's authority. It was conceded by the state that the tribe had jurisdiction over members and may also regulate nonmembers. The state argued, however, that it was entitled to concurrent jurisdiction over nonmembers. The Tribe countered that New Mexico's regulations would interfere with the Tribes' rule-making authority and with its internal affairs.

The Court agreed with the Tribe, but announced a test rooted in preemption which has overshadowed the *Williams* case. The Court stated:

State jurisdiction is preempted by the operation of federal law if it interferes or is incompatible with federal and tribal interests reflected in federal law, unless the state interests at stake are sufficient to justify the assertion of state authority.⁸¹

This test did not rely on sovereignty, but approached the issue from a balancing perspective. The Court weighed the interests of the state and services provided by them against federal and tribal interests in arriving at its decision. Ultimately, the Court decided the state scheme would greatly disturb federal and tribal efforts which had significantly improved hunting and fishing conditions on the reservation.

79. *Id.* at 223.

80. 462 U.S. 324 (1983).

81. *Id.* at 334.

This case marked a quiet departure from sovereignty and entered the area of preemption which has formed the basis of a state tax analysis with regard to Indians. Although the *Williams* test is still used, the balancing approach of *Mescalero Apache Tribe* seems to be the preferred method of dealing with tribal-state conflicts.

C. Preemption

The United States Supreme Court has consistently held that absent Congressional consent, states may not tax Indian trust lands.⁸² This has been held to include not only federal trust lands, but lands owned by Indians on the reservation.⁸³ This, however, does not end the inquiry, as several arguments and events have added uncertainty to that exemption. Congress, in 1924, allowed the states to tax royalties from mineral leases on Indian trust lands.⁸⁴ This tax could be applied against the Indians' royalty interest under the statute. This shows that Congress may change the status of the tribes at any time. This taxing power was repealed in 1939, but is important in demonstrating the existence of doubt in this area.

An interesting question arose in 1912 when the Supreme Court decided the case of *Choate v. Trapp*.⁸⁵ This case involved lands in Oklahoma allotted by the United States to members of the Choctaw and Chickasaw Tribes in 1897. These lands were issued with restrictions from the sale and encumbrance of the land. When Oklahoma was admitted into the union in 1907, the status of the Indians' land remained unchanged, and their restrictions on alienation forbade taxes on the land by the state.

In 1908, Congress removed the restriction on the lands held by the Indians, and as part of that removal, stated that these lands were now subject to taxation. The state then sought to assess the lands for taxes through the state courts. The Tribal members disagreed with the state and argued the tax exemption could not be unilaterally removed. The case eventually made its way to the Oklahoma Supreme Court, where the state successfully asserted that since Oklahoma was not a party to the contract with the Indians they were not bound. Secondly, the United States, through its power over the Indians could have substituted title in severalty for ownership in common without the Indians' consent, and lastly that the tax exemption provision of the contract lacked consideration and could be withdrawn by the federal government at any time. The Tribal members argued that the tax exemption was a vested property right and any removal was a taking. Since they had not been compensated for that taking, the tax exemption removal was null and void.

82. *The Kansas Indians*, 72 U.S. (5 Wall.) 737 (1866).

83. *Bryan v. Itasca County*, 426 U.S. 373 (1976).

84. 25 U.S.C. § 398 (1994).

85. 224 U.S. 665 (1912).

The case was appealed to the United States Supreme Court. The Court first examined the contract itself. After 1871, the United States ceased to enter into treaties with the Indian tribes and this agreement was in fact a contract.⁸⁶ Also, the Supreme Court had held in the past that the United States may abrogate a treaty with an Indian tribe at any time.⁸⁷ That was usually the case with contracts also, but not here. The Court reasoned that although the United States could break the contract, a distinction was warranted between private property and tribal property and between the power to abrogate a statute and the authority to destroy rights.⁸⁸ The contract was such an integral part of the Curtis Act of 1898⁸⁹ that it could not be severed, as rights granted were now protected by the United States Constitution. In most cases, the United States Constitution does not apply to Indians, but the Curtis Act had granted citizenship to the Choctaws and Chickasaws who were a party to this contract. In this case, the members had been granted the allotments with the tax exemption in exchange for relinquishment of all claims to other lands. This supplied all the necessary consideration for the contract and the Court further stated that the Indians did in fact have a property right in the exemption.

The state argued that the tax provision was not an exemption, but merely an additional restriction on alienation. When all restrictions were removed, so was the tax exemption. The Court answered this argument by distinguishing the exemption from the restriction. It stated that one was right and the other a limitation.

The Court also held that the usual rule is that tax exemptions should be strictly construed and subject to repeal unless the contrary clearly appears.⁹⁰ This, however, was held not to apply in this case dealing with Indians. The Court held that "the construction, instead of being strict, is liberal; doubtful expressions, instead of being resolved in favor of the United States, are to be resolved in favor of a weak and defenseless people, who are wards of the nation, and dependent wholly upon its protection and good faith."⁹¹

The argument advanced by the state that it was not a party to the contract and should not be bound was rejected by the Court. By determining the exemption was a right granted by law and protected by the Constitution, Oklahoma was bound, and their absence at the execution of the contract was irrelevant.

86. WILLIAM C. CANBY, *AMERICAN INDIAN LAW IN A NUTSHELL* 87 (2d ed. 1988) (citing 25 U.S.C.A. § 71 ("No Indian nation or tribe . . . shall be acknowledged or recognized as an independent nation, tribe, or power with whom the United States may contract by treaty.")).

87. *Lone Wolf v. Hitchcock*, 187 U.S. 553 (1903).

88. *Choate*, 224 U.S. at 671.

89. Ch. 517, 30 Stat. 495, modified by Choctaw-Chickasaw Supplemental Agreement of 1902, ch. 1362, 32 Stat. 641.

90. *Choate*, 224 U.S. at 674.

91. *Id.* at 675.

Having addressed the issues involved, the Court further held that the tax exemption removal amounted to an attempted taking without compensation and was a nullity. The Oklahoma Supreme Court was reversed and the exemption stood. It is important to note this case rested on federal preemption and contract principles versus sovereignty and demonstrated the Courts' hesitancy to depend too heavily on resolving these issues by resting on an area with no clear definition.

V. McClanahan v. Arizona State Tax Commission

*McClanahan v. Arizona State Tax Commission*⁹² was important for several reasons. First, it dealt with a state's income taxation of Indians. Secondly, it is important because the court was clear in its holding, and answered many unresolved issues. Unfortunately, some issues were left unresolved and over time, the case has been interpreted so narrowly by some state courts that it may be limited to its set of facts.

The conflict involved an enrolled member of the Navajo Tribe who earned income solely within the Navajo reservation. During that year, \$16.20 was withheld from her wages to satisfy her state tax liability. The taxpayer then filed a claim for a refund with the state and protested the tax. No action was taken by the state, and the taxpayer sued the tax commission in the state court.

The state tax commission was successful in all stages of litigation at the state level. The Arizona Supreme Court interpreted *Williams v. Lee* as protecting the rights of the tribe as a whole, and not individual Indians. The court reasoned that the state taxes did not interfere with the Tribe's governmental functions and was permissible under previous United States Supreme Court holdings. The taxpayer appealed the decision of the Arizona Supreme Court and the United States Supreme Court reversed.

First, the Supreme Court recognized this case dealt with the state taxation of the income of a reservation Indian on the reservation. The Court rejected the Arizona Supreme Court's determination that this case did not involve tribal interests by holding that since all relevant activity took place on the reservation, all governing responsibility was with federal government and the tribe. The Court also rejected Arizona's argument that in situations where tribal governments are not affected, states are free to legislate. The Court held federal law is supreme and it is meant to protect individual Indians' right to govern themselves, and since tribes are made up of individuals, tribes are always affected.

This may lead one to believe sovereignty is alive, but, the Court also relied on *Warren Trading Post Co. v. Arizona Tax Commission*,⁹³ which rested on

92. 411 U.S. 164 (1973).

93. 380 U.S. 685 (1965).

preemption grounds. *Warren Trading Post* involved a non-Indian trading post on the Navajo reservation which was taxed by the state on its gross receipts. The Supreme Court held that the tax was invalid because the trading post was already subject to extensive federal regulations and no room remained for state laws. This seems to take us back to the preemption argument, which appears today to be most favored.⁹⁴ The Court in *McClanahan* also looked to the treaty between the Navajos and the United States and the fact that Arizona lacked civil and criminal jurisdiction over the reservation in striking down the tax.

In essence, this case seemed to say that states could simply not tax the income of Indians if they earned it in Indian country. It seemed clear on its face, but, it was only the beginning of the uncertainty which is still being resolved today.

In *Washington v. Confederated Tribes of the Colville Indian Reservation*,⁹⁵ the Supreme Court distinguished between enrolled members of a tribe and nonmember Indians present on a reservation. In this case, the state sought to impose cigarette taxes on sales to nonmembers of the Tribe. The Court rejected the Tribe's argument that the state taxes would unduly burden and interfere with governmental functions by reasoning that nonmember Indians stand on the same footing as non-Indians. That is, these persons are not constituents of the Tribe and the state may regulate and tax them. In addition, the Court held the Tribe is not denied the right to impose its own taxes by the imposition of state taxes. This further emphasized the Court's position that the state tax did not interfere with or prevent the tribal government's operation.

This case relied primarily on federal preemption to determine the outcome, and is but one of many cases subsequent to *McClanahan* which continued to narrow its scope. Nevertheless, *McClanahan* is important because it established a first step in resolving questions of state taxation with regard to Indians.

In the gambling area, tribal membership of Indians in the tribe is what determines whether or not individual employees are subject to state income taxes and other state taxes. In this area, federal case law treats nonmember Indians as non-Indians, although the same person may be an "Indian" under other federal statutes.⁹⁶

94. The current case illustrating the test to be used is *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 142 (1980) (stating that the Court uses both the preemption test and state infringement test and views them both against a backdrop of tribal sovereignty).

95. 447 U.S. 134 (1980).

96. See 25 U.S.C. § 479 (1994) ("For purposes of the Indian Reorganization Act, the term 'Indian' shall include all persons of Indian descent who are members of any recognized Indian tribe now under Federal jurisdiction, . . . and shall further include all other persons of one-half or more Indian blood).

VI. When States May Tax

Every Indian who earns income or undertakes any taxable activities outside of Indian country is subject to state taxation.⁹⁷ This also applies to an Indian tribe which operates a business outside of Indian country.⁹⁸ After *Colville*, it is possible that nonmembers could be subject to state income taxes also when they earn income on a reservation other than their own. Although no United States Supreme Court case has so held, *Colville* can reasonably be extended beyond sales and cigarette taxes by its broad language.⁹⁹ In addition, *McClanahan* has been interpreted by the Wisconsin Supreme Court as exempting from state income taxes income earned by tribal members on their reservation only if they also live on the reservation.

In *Anderson v. Wisconsin Department of Revenue*,¹⁰⁰ the taxpayer served as a guidance counselor at the Tribe's high school, and in other various educational positions. The taxpayer argued that since he was an enrolled member and the educational income was earned on the reservation, Wisconsin could not tax him, in accordance with *McClanahan*. The state argued that *McClanahan* exempted only "reservation" Indians, and since Anderson did not live on the reservation, he did not qualify for the exemption. The Wisconsin Supreme Court agreed with the state by defining "reservation Indian" as an Indian who works, earns income, and also lives on the reservation. Since *McClanahan* involved a Navajo who lived on the reservation, the Wisconsin Court reasoned, it did not apply in this case.

Anderson also argued that Wisconsin's tax infringed upon tribal self-government and federal policies favoring educational opportunities for Indians by causing additional sums of money to be depleted unnecessarily to pay state taxes. Anderson also cited *Ramah Navajo School Board v. Bureau of Revenue*,¹⁰¹ in which the United States Supreme Court held invalid a state gross receipts tax on a non-Indian construction company building a school on an Indian reservation. Anderson argued that due to federal policies favoring

97. See *Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973).

98. *Id.*

99. *Colville*, 447 U.S. at 161. The Court stated:

Nor would the imposition of Washington's tax on these purchasers contravene the principle of tribal self-government, for the simple reason that non-members are not constituents of the governing tribe. For most practical purposes those Indians stand on the same footing as non-Indians resident on the reservation. There is no evidence that nonmembers have a say in tribal affairs or significantly share in tribal disbursements. We find, therefore, that the State's interest in taxing these purchasers outweighs any tribal interest that may exist in preventing the State from imposing its taxes.

Id.

100. 484 N.W.2d 914 (Wis. 1992), *cert. denied*, 508 U.S. 941 (1993).

101. 458 U.S. 832 (1982).

education and regulation, state law was preempted and no action by the state was allowed or needed. The State responded by distinguishing *Ramah* in several respects.

First, the construction company was regulated extensively in its daily affairs by the federal government, which was not the case here. In addition, no services were provided to the construction company by the state in *Ramah*. The Wisconsin Court declared that all citizens who enjoy services of the state must share the burden of taxation. Since Anderson chose to live off of the reservation, he received many services from the state, which he must help pay for. Secondly, the Tribe reimbursed the construction company for all taxes paid in *Ramah*, so the burden fell directly upon it. The court further stated that unless Anderson found a way to have the Tribe reimburse him, the Tribe carried no burden of state taxation. Lastly, the court reasoned that no explicit Congressional policy could be found favoring education in this case, which further distinguished this case from *Ramah*.

At times the Wisconsin Supreme Court seemed to read federal case law with too stringent and narrow a view. While it was true that no specific act of Congress favored Anderson's tribe and situation, the federal government has in other instances stated its goal of educating Indians so that they may achieve self-sufficiency.¹⁰² Anderson was not alone, as the dissent also supported the idea that educational policies of the federal government preempted Wisconsin's state income tax.¹⁰³

The reasoning of the Wisconsin Supreme Court was followed by the Utah Supreme Court in *Fatt v. Utah State Tax Commission*.¹⁰⁴ In *Fatt*, the taxpayer was called to active duty and left his domicile on the reservation to serve in the United States Navy. The state income tax was held invalid, because, unlike Anderson, Fatt did not voluntarily abandon his reservation

102. See Indian Self-Determination & Education Assistance Act of 1975, 25 U.S.C. § 450a(c) (1994). The section states:

[A] major national goal of the United States is to provide the quantity and quality of educational services and opportunities which will permit Indian children to compete and excel in the life areas of their choice, and to achieve the measure of self-determination essential to their social and economic well-being.

Id.

103. *Anderson*, 484 N.W.2d at 924 (Abrahamson, J., dissenting). The dissent stated: In concluding that federal caselaw does not preempt state taxation in this case, the majority understates the relevant federal and tribal concerns and overstates the relevant state interests. The majority essentially relies on two considerations to support its conclusion that the state tax is not preempted: (1) the absence of a "pervasive federal regulatory scheme" governing tribal education and (2) the absence of detailed federal regulations specifically governing compensation paid to individuals in Anderson's position. While these considerations are certainly relevant to the preemption analysis, they in no way preclude the conclusion that federal law preempts state taxation in this case.

Id.

104. 884 P.2d 1233 (Utah 1994).

home. The Utah court also supported the public policy that citizens should be encouraged to serve in the armed forces.

The reasoning used was similar to *Anderson*, and most likely would have applied in a similar situation in Utah if an enrolled member of an Indian tribe chose to live off of the reservation, but continued to earn income there.

If an enrolled tribal member voluntarily lives off of the reservation and is employed by a gambling enterprise, the income may be taxable by the state. Tribal members must look to the law of their state to find the answer. As certiorari was denied by the United States Supreme Court in *Anderson*, this dispute may not be answered by the Supreme Court for a long time to come. The states are free to implement their own laws as long as they do not conflict with previous federal case law.

With regard to tribes, though, states face additional burdens. In the Tenth Circuit, it has been held that a state's interest in preventing organized crime did not justify its taxation of a tribal gambling enterprise located on non-trust land.¹⁰⁵ Despite the fact the land was not held in trust by the United States, and the Tribe owned the land in fee simple, the court held it was "Indian Country." This meant it was out of reach of the state taxing authority unless Congress divested the land of its status. In addition, the court held the lands did not have to be formally called a "reservation."

It appears states may tax the income of member Indians earned on the reservation if they do not live there. Tribal enterprises, however, continue to be exempt, in most instances, from state taxes and regulation while on the reservation or in Indian country. Even though no concrete rule of law has been established by Congress or the United States Supreme Court, a compelling state interest is a common factor examined by the courts in deciding the validity of state laws on an Indian reservation. As one can see, what constitutes a compelling state interest is in the eye of the examining court.

VII. Conclusion

The law in this area is quite confusing and unsettled. This presents numerous difficulties for our courts and judges to overcome in the resolution of disputes. The seemingly inconsistent interpretations by the United States Supreme Court in this area caused Chief Justice Rehnquist to declare in *Ramah Navajo School Board v. Bureau of Revenue*:

The general question presented by this cause has occupied the Court many times in the recent past, and seems destined to demand its attention over and over again until the Court sees fit to articulate, and follow, a consistent and predictable rule of law.

105. *Indian Country, U.S.A. v. State of Oklahoma ex rel. Oklahoma Tax Comm'n*, 829 F.2d 967 (10th Cir. 1987).

This insistent question concerns the extent to which the States can tax economic activity on Indian reservations within their borders.¹⁰⁶

A. Federal Taxation

Federal taxation of Indians seems to be better developed than state taxation. This is probably because the federal model has had more time and fewer constraints in its evolution. Also, the federal agencies in charge of implementing Congress' objectives provide feedback to Congress on the success or failure of those policies rather quickly.

Also, the reservations receive benefits from the federal government which flow through to the individual members. The beneficiaries must then bear the burden of taxation as all United States citizens must.

Furthermore, federal law is supreme and when needs change regarding the reservations the federal government can simply do what it needs to. The federal government does not have to consider state interests in governing the tribes and has set forth clear rules regarding taxation of Indians. Unless an express policy is expressed by Congress, or a statute enacted exempting Indians from federal taxation, Indians are subject to federal taxes. This applies in the gambling context as well. While gambling enterprises entered into by Indian tribes are clearly favored by the federal government, so are federal taxes.

B. State Taxation

State taxation, on the other hand, is unsettled for many reasons. State tax law is not well-developed because it exists at the mercy of the federal government's laws and policies. Before a state tax can be implemented, safeguards imposed by Congress to protect the tribes must be contended with. Although sovereignty does not insulate a tribe from state taxes, a balancing approach is used by the federal courts. The competing interests of the federal government, the tribes, and the states are considered. Since no "bright line" rule has been enacted, each case must be examined and the balancing test must be conducted. States are frustrated at the loss of potential revenue due to the inability to tax some of their citizens. Many state officials argue that gambling has introduced organized crime along with additional expenses for law enforcement, but no corresponding increase in tax revenues. These arguments have met with some success, as states have gained ground in the taxing of Indians in certain circumstances.

Historically, tribes and states have had adversarial relationships, and this has carried through to the taxing arena. Tribes continue to resist taxation by states because it is perceived as another attempt to infringe on their authority

106. *Ramah*, 458 U.S. at 847 (Rehnquist, J., dissenting).

as a governmental entity. Tribes feel that states have not dealt fairly with them in the past, and do not understand their needs.

As long as each side does not recognize the other and refuses to negotiate, the difficulties and conflicts will remain. With the apparent success of Indian gambling enterprises in this country, a joint undertaking between tribes and states would certainly produce benefits for each. A common ground for the tribes and states must be found which would relieve the staggering levels of unemployment and poverty on Indian reservations, while at the same time producing revenues for the states.

For example, the tribes and states could share in the tax revenues collected. Tribes have argued that state taxes produce no benefit for them and they are ignored by state governments. In order to help alleviate this concern, the tribes could collect all state taxes on the reservation and retain a portion for themselves.¹⁰⁷ This would certainly ensure compliance as the tribes would see the direct benefits produced by state taxes. Not only would states collect taxes they normally may not receive, the voluntary remittance would keep administrative costs low.

Once agreements are reached, resources can be allocated to produce prosperous gambling enterprises with beneficial results. This is preferable to resolving arguments between the tribes and states through lengthy and expensive litigation. The parties involved will be around for a very long time, and the key to success for everyone lies in compromise and not conflict.

107. See Russel L. Barsh, *Issues in Federal, State, and Tribal Taxation of Reservation Wealth: A Survey and Economic Critique*, 54 WASH. L. REV. 531, 575 (1979) (stating that the Oglala Sioux Tribe collects South Dakota's sales tax and retains a portion for the Tribe's use).