American Indian Law Review

Volume 8 | Number 2

1-1-1980

Taxation: State Taxation of Indian Transactions: The Test After Colville, White Mountain Apache, and Central Machinery

Landon Westbrook

TAXATION: STATE TAXATION OF INDIAN TRANSACTIONS: THE TEST AFTER *COLVILLE, WHITE MOUNTAIN APACHE,* AND *CENTRAL MACHINERY*

Landon Westbrook

This note discusses state taxation of Indian transactions, both on-reservation and off-reservation, in light of three recent decisions by the United States Supreme Court: *Washington v. Confederated Tribes, Colville Indian Reservation (Colville),*[1] *White Mountain Apache Tribe v. Bracker,*[2] and *Central Machinery Co. v. Arizona Tax Commission.*[3] An Indian transaction is one in which at least one party to the transaction is an Indian. An Indian is an enrolled member of the tribe for purposes of activities or transactions affecting his tribe's reservation or sovereignty status. In the light of current law, transactions between non-Indians are taxable by the state whether they occur on-reservation[4] or off,[5] due in part to the state's interest in regulating the conduct of its citizens wherever they may be located in the state.

The Court in *White Mountain Apache* considered the boundaries between state regulatory authority and tribal authority[6] and concluded that, "there is no rigid rule by which to resolve the question whether a particular state law may be applied to an Indian reservation or to tribal members."[7] Despite the lack of "rigid" or mechanical rules to determine the extent of state taxing power, there are guidelines that may be followed to determine if a particular tax is applicable.

While not all questions relating to state taxation of Indian transactions have been examined, certain transactions have been decided. The sales of cigarettes to non-Indians is taxable by the state.[8] The purchaser is defined to be a non-Indian when he is not an enrolled member of the tribe(s) on whose reservation the

1. 447 U.S. 134 (1980).

2. 448 U.S. 136 (1980).

3. 448 U.S. 16 (1980).

4. *See* Thomas v. Gay, 169 U.S. 264 (1898). *See also* Washington v. Confederated Tribes, Colville Res., 447 U.S. 134 (1980).

5. The right of a state to tax its citizens in a nondiscriminatory manner flows from the sovereign status of the state.

6. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 139-40 (1980).

7. *Id.* at 139.

8. Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463 (1976).

cigarette sale takes place.[9] For example, a fullblood Apache enrolled on his tribe's rolls would be a non-Indian for purposes of the cigarette sales tax if he were to buy cigarettes on the Colville Reservation.

Sales to Indians by a licensed federal Indian trader located on the reservation are not taxable by the state.[10] The gross receipts of an off-reservation tribally operated enterprise on federal land are taxable, although the land and the fixtures are not taxable.[11] The gross receipts of a non-Indian logging company operating solely on the reservation were held to be nontaxable in *White Mountain Apache.*[12] The on-reservation sale of farm tractors to a tribal enterprise by a non-Indian located off the reservation was held to be free from the state transaction tax.[13]

A reading of the above cases leaves one with the impression that there is no test that can be applied to determine when a state's tax will apply. However, on closer reading, a three-level test seems to be applicable. The first level is the preemption level wherein the issue of federal preemption is determined. Level two looks at the presence of a legitimate state interest. Level three uses an infringement test. Failure of the state to pass the test of any level causes the transaction or activity to be nontaxable.

Preemption

The first level of analysis for a state tax on Indian transactions is preemption. Preemption is based on the plenary and exclusive power of the federal government to deal with Indian tribes[14] and "to regulate and protect the Indians and the property against interference even by a state."[15] The preemption analysis is supported by the deeply rooted policy of the United States to leave the Indians free from state jurisdiction and control.[16] Preemption is further supported by the extensive federal legislative and administrative regulation of Indian tribes and reservations.[17] "Con-

9. Washington v. Confederated Tribes, Colville Res., 447 U.S. 134 (1980).
10. Warren Trading Post v. Arizona Tax Comm'n, 380 U.S. 685 (1965).
11. Mescalero Apache Tribe v. Jones, 411 U.S. 145 (1973).
12. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 140-41 (1980).
13. Central Mach. Co. v. Arizona Tax Comm'n, 448 U.S. 16 (1980).
14. United States v. Mazurie, 419 U.S. 544, 554 n.11 (1975); Morton v. Mancari, 417 U.S. 535, 551-52 (1974); Board of Comm'rs v. Seber, 318 U.S. 705, 715-16 (1943).
15. Board of Comm'rs v. Seber, 318 U.S. 705 (1943).
16. McClanahan v. Arizona Tax Comm'n, 411 U.S. 164, 168-70 (1973).
17. Bryan v. Itasca County, 426 U.S. 373 n.2 (1976), *citing* McClanahan v. Arizona Tax Comm'n, *supra*, at 173-79.

gress has also acted consistently upon the assumption that the States have no power to regulate the affairs of Indians on a reservation."[18] *McClanahan* states that:

> "State laws generally are not applicable to tribal Indians on an Indian reservation except where Congress has expressly provided that State laws shall apply. It follows that Indians and Indian property on an Indian reservation are not subject to State taxation except by virtue of express authority conferred upon the State by act of Congress." U.S. Department of the Interior, Federal Indian Law 845 (1958).[19]

In discussing the trend of cases *McClanahan* states that:

> The trend has been away from the idea of inherent Indian sovereignty as a bar to state jurisdiction and toward reliance on federal pre-emption. (see *Mescalero* at p. 145.) The modern cases thus tend to avoid reliance on platonic notions of Indian sovereignty and to look instead to the applicable treaties and statutes which define the limits of state power. (Citations omitted.)
>
> The Indian sovereignty doctrine is relevant, then, not because it provides a definitive resolution of the issues in this suit, but because it provides a backdrop against which the applicable treaties and federal statutes must be read.[20]

The Court in *Mescalero* stated that:

> The conceptual clarity of Mr. Chief Justice Marshall's view in Worcester v. Georgia, 6 Pet. 515, 556-561 (1832), has given way to more individualized treatment of particular treaties and specific federal statutes, including statehood enabling legislation, as they, taken together, affect the respective rights of States, Indians, and the Federal Government. (Citations omitted.)[21]

In determining how the preemption test applies to Indian activities and transactions, the first step is to determine the scope of federal involvement in the area. To determine the scope of federal involvement, the relevant treaties and statutes must be considered. If there is a comprehensive regulatory scheme, then

18. Williams v. Lee, 358 U.S. 217, 220 (1959).
19. McClanahan v. Arizona Tax Comm'n, 411 U.S. 164, 170-71 (1973).
20. *Id.* at 172.
21. Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148 (1973).

there is no room for the state to impose additional burdens.[22] Step two looks at the location of the activity and where the value sought to be taxed arose.

For on-reservation activities, specific preemption of state authority is not necessarily required as there is a geographical component that remains highly relevant in determining the limits of state authority.[23] Where the value sought to be taxed arises on the reservation, the state will be preempted by *McClanahan*.[24] Where the value arises off the reservation, the state's taxing of sales to Indians would be prohibited, but taxing of sales to non-Indians would be allowed under *Moe*[25] and *Colville*.[26] *White Mountain Apache* tells us that it is simply not the law that a state may "assess taxes on non-Indians engaged in commerce on the reservation whenever there is no express Congressional statement to the contrary."[27]

The issue of on-reservation sales to Indians living off the reservation has not yet been addressed, although the *Moe* Court noted the existence of the issue.[28] It would seem that once the Indian returned to the reservation, for however short a time period, that the tribe's jurisdiction over him would divest the state's taxing interest for sales made on the reservation. In light of the current cases, for the sale of items (whose value arises off the reservation) to be nontaxable the seller would have to be the tribe[29] or a federally licensed Indian trader,[30] or the transaction would have to be covered by federal trader statutes.[31]

For off-reservation activities, preemption starts with the premise that the state has the authority to regulate activities within its domain. In the absence of "express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to non-discriminatory state law otherwise applicable to all citizens of the State. (Citations omitted.) That principle is as relevant to a State's tax laws as it is to state

22. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 143 n.15 (1980).
23. *Id.*
24. McClanahan v. Arizona Tax Comm'n, 411 U.S. 164, 179-80 (1973).
25. Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463, 475-81 (1976).
26. Washington v. Confederated Tribes, Colville Res., 447 U.S. 134, 140 (1980).
27. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 141 (1980).
28. Moe v. Confederated Salish & Kootenai Tribes, 425 U.S. 463 (1976).
29. *Id.*, by implication. *See also* Washington v. Confederated Tribes, Colville Res., 447 U.S. 134 (1980).
30. Warren Trading Post v. Arizona Tax Comm'n, 380 U.S. 685 (1965).
31. Central Mach. Co. v. Arizona Tax Comm'n, 448 U.S. 16 (1980).

criminal laws (citation omitted). . . .'"[32] Hence, preemption of off-reservation activities would require specific legislation directed to this activity.[33]

The gross receipts of a tribally operated, off-reservation ski resort were subjected to state tax in *Mescalero*.[34] The Court did not make a distinction between receipts from Indians or non-Indians, but that distinction does not seem to be especially relevant in light of the Court's broad statements in *Mescalero* about nondiscriminatory taxes applying to Indians and non-Indians.[35] However, one Tenth Circuit case decided after *Mescalero* held "that sales not on trust lands by the Tribe to Indians only are not within the state taxing power."[36]

The *Ute* case dealt, in part, with the sale, of personal property, made by the tribe on the reservation, to an Indian, the sale occurring off the reservation. The Tenth Circuit held that sale was not taxable by the state.[37] Hence, off-reservation sales to Indians, where the value sought to be taxed arose on the reservation, will not be taxable by the state.

The basic statement of the preemption analysis is, if the federal regulatory scheme is pervasive, then additional burdens by the state are precluded.[38] If federal regulation does not preclude the state, then it goes to the second level of analysis.

Legitimate State Interest

The second level of test is the legitimate state interest analysis. A basic premise of this analysis is that there is no federal legislation either allowing or disallowing the state's taxation. A second premise is that the activities or transactions sought to be taxed will normally occur on the reservation because *Mescalero*[39] and the state's sovereign taxing power will tend to uphold nondiscriminatory taxes off the reservation. This second premise is further supported by the following language in *White Mountain Apache*:

32. Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-49 (1973).
33. Oklahoma Tax Comm'n v. Texas Co., 336 U.S. 342, 365-66 (1949).
34. Mescalero Apache Tribe v. Jones, 411 U.S. 145 (1973).
35. *Id.* at 148-49.
36. Ute Indian Tribe v. Utah Tax Comm'n, 574 F.2d 1007, 1009 (10th Cir. 1977), *reh. denied.*
37. *Id.*
38. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 141 (1980).
39. Mescalero Apache Tribe v. Jones, 411 U.S. 145 (1973).

> And equally important, respondents have been unable to identify any regulatory function or service performed by the State that would justify the assessment of taxes for activities . . . within the reservation.[40]
>
> . . .
>
> [T]his is not a case in which the State seeks to assess taxes in return for governmental functions it performs for those on whom the taxes fall. Nor have respondents been able to identify a legitimate regulatory interest served by the taxes they seek to impose. They refer to a general desire to raise revenue, but we are unable to discern a responsibility or service that justifies the assertion of taxes imposed for on-reservation operations. . . .[41]

The Court in *White Mountain Apache* looked for a legitimate regulatory interest to justify the state's tax.[42] A legitimate state interest would occur when the state is providing some service or function for those on whom the taxes fall, or when the state has a legitimate regulatory interest served by the taxes it seeks to impose.[43] Hence, a state must have a legitimate state interest in order to impose its regulatory authority over an activity or transaction. After passing the preemption level, this test should be easy to pass as preemption will tend to weed out situations like *White Mountain Apache* where the federal government has completely occupied the field through its regulations. The state will have to show a causal link between its taxing and the transactions sought to be taxed before it proceeds to the third level of analysis.

Infringement

The third level of analysis is the infringement test. A basic assumption of this analysis is that both the tribe and the state have jurisdiction over the area, otherwise there would be nothing to "infringe" upon.

The infringement test was born in *Williams v. Lee*[44] wherein the Court stated: "Essentially, absent governing Acts of Congress, the question has always been whether the state action in-

40. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 141 (1980).
41. *Id.*
42. *Id.* at 141-42.
43. *Id.*
44. Williams v. Lee, 358 U.S. 217 (1959).

fringed on the right of reservation Indians to make their own laws and be ruled by them."[45] In *McClanahan* the Court looked at the infringement test and stated:

> It must be remembered that cases applying the Williams test have dealt principally with situations involving non-Indians. See also Organized Village of *Kake v. Egan*, 369 U.S., at 75-76. In these situations, both the tribe and the State could fairly claim an interest in asserting their respective jurisdictions. The *Williams* test was designed to resolve this conflict by providing that the State could protect its interest up to the point where tribal self-government would be affected.[46]

The infringement test then appears to have three requirements: (a) absent governing acts of Congress, (b) an infringement on the rights of reservation Indians to make their own laws and be ruled by them, and (c) principally non-Indians are affected by the state's actions. Requirement (a) of the test is a recognition of the fact that the federal preemption test must be passed before the issue of infringement can arise. Thus the infringement test looks to parts (b) and (c) for the solution of the tribe-state conflict.

While the Court has not specifically stated how it views the infringement test, it appears to view it as a balancing of interests. The Court in *White Mountain Apache* said:

> We have thus rejected the proposition that in order to find a particular state law to have been preempted by operation of federal law, an express congressional statement to that effect is required. *Warren Trading Post Co. v. Arizona Tax Comm'n*, supra. *At the same time any applicable regulatory interest of the State must be given weight. McClanahan v. Arizona State Tax Comm'n*, supra, 411 U.S., at 171, 93 S.Ct., at 1261. . . .[47]

In *Colville*, while discussing the infringement test of *Williams v. Lee*, the Court says:

> The principle of tribal self-government, grounded in notions of inherent sovereignty and in congressional policies, seeks an *accommodation* between the interests of the Tribes and the Federal Government, on the one hand, and those of the State, on the other. *McClanahan v. Arizona State Tax Comm'n*, 411 U.S. 164, 179, 93 S.Ct. 1257, 1266, 36 L.Ed.2d 129 (1973).[48]

45. *Id.* at 220.
46. McClanahan v. Arizona Tax Comm'n, 411 U.S. 164, 179 (1973).
47. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 139 (1980).
48. Washington v. Confederated Tribes, Colville Res., 447 U.S. 134, 139 (1980).

Colville continues by discussing the extreme parameters of the infringement test:

> While the Tribes do have an interest in raising revenues for essential governmental programs, that interest is strongest when the revenues are derived from value generated on the reservation by activities involving the Tribes and when the taxpayer is the recipient of tribal services. The State also has a legitimate governmental interest in raising revenues, and that interest is likewise strongest when the tax is directed at off-reservation value and when the taxpayer is the recipient of state services.[49]

In *White Mountain Apache*, the Court, looking at the same parameters, stated:

> When on-reservation conduct involving only Indians is at issue, state law is generally inapplicable, for the State's regulatory interest is likely to be minimal and the federal interest in encouraging tribal self-government is at its strongest. . . . (Citations omitted.)
>
> More difficult questions arise where, as here, a State asserts authority over the conduct of non-Indians engaging in activity on the reservation. In such cases we have examined the language of the relevant federal treaties and statutes in terms of both the broad policies that underlie them and the notions of sovereignty that have developed from historical traditions of tribal independence. This inquiry is not dependent on mechanical or absolute conceptions of State or tribal sovereignty, but has called for a particularized inquiry into the nature of the State, Federal, and tribal interests at stake, an inquiry designed to determine whether, in the specific context, the exercise of state authority would violate federal law. (Citations omitted.)[50]

The Court has given the parameters of the infringement test and has also given some factors to be considered in balancing and weighing the interest in the tribe-state conflict.

Two congressional policies have emerged as relevant on the Indian side of the inquiry: (1) the encouragement of reservation economic development[51] and (2) the promotion of tribal self-

49. *Id.* at 138.
50. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 140 (1980).
51. *Id.*

sufficiency.[52] The Court in *White Mountain Apache* gives the justification for the above two policies in footnote 10 wherein it says:

> For example, the Indian Financing Act of 1974, 25 U.S.C. § 1451 et seq., states: "It is hereby declared to be the policy of Congress . . . to help develop and utilize Indian resources, both physical and human, to a point where the Indians will fully exercise responsibility for the utilization and management of their own resources and where they will enjoy a standard of living from their own productive efforts comparable to that enjoyed by non-Indians in neighboring communities." Similar policies underlie the Indian Self-Determination and Education Assistance Act of 1975, 25 U.S.C. § 450 et seq., as well as the Indian Reorganization Act of 1934, 25 U.S.C. 461 et seq., whose "intent and purpose . . . was 'to rehabilitate the Indian's economic life and to give him a chance to develop the initiative destroyed by a century of oppression and paternalism'." (Citations omitted.)[53]

The state interests to be considered include: (1) protection of legitimate, off-reservation tax revenues[54] and (2) the taxation of those to whom state functions and services are provided.[55] Hence, the infringement analysis will require "a particularized inquiry into the nature of the State, Federal, and Indian interests at stake. . . ."[56]

Application

In *Colville* the use of the three-level analysis would conclude in the same result, given the Court's acceptance of the "fact" that the burden of the state's cigarette tax was on the purchaser and not the tribe.[57] There would be no federal preemption because of the lack of federal regulation regarding the cigarette tax. The state would have a legitimate interest in taxing cigarettes sales because of its desire to regulate their use and the fact that the value being marketed was the tribe's tax exclusion.[58] The final

52. *Id.*

53. *Id.* at 141. *See also* Washington v. Confederated Tribes, Colville Res., 447 U.S. 134 (1980).

54. *See* Washington v. Confederated Tribes, Colville Res., 447 U.S. 134 (1980).

55. See generally the discussion under "Legitimate State Interest."

56. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 140 (1980).

57. Washington v. Confederated Tribes, Colville Res., 447 U.S. 134 n.28 (1980).

58. *Id.* at 135.

test was then conducted at the infringement level, with the scales weighted for the state because of the holding in *Moe* that the cigarette tax collection burden is "minimal."[59] However, stronger arguments regarding the actual incidence, not just the legal incidence,[60] of a tax could turn the tables in favor of the tribe at the federal preemption level.[61]

White Mountain Apache was clearly decided at the federal preemption level[62] because of the pervasive federal regulation of tribal timber activities.[63]

Central Machinery was decided at the federal preemption level, not because of specific adherence to the Indian trader statutes but rather because "[i]t is the existence of the Indian trader statutes, then, and not their administration, that pre-exempts the field of transactions with Indians occurring on reservations."[64]

Conclusion

Despite the difficulties of providing rigid guidelines for deciding cases where a state attempts to tax an Indian transaction, the Supreme Court has posed a three-level test to determine if the state may apply its tax:

First, is the area preempted by the federal government? If so, then the state cannot apply its tax; if not, then: *Second*, does the state have a legitimate interest? If not, then the state cannot apply its tax; if so, then: *Third*, does the tax infringe on the tribe's rights? If so, then the state cannot apply its tax; if not, then the state *may* apply its tax.

59. *Id.* at 134.

60. *Id.*

61. *See* Barsh, *Issues in Federal, State and Tribal Taxation of Reservation Wealth: A Survey and Economic Critique*, 54 WASH. L. REV. 531, 560-68 (1979). *See also* Note, *Balancing the Interests in Taxation of Non-Indian Activities on Indian Lands*, 64 IOWA L. REV. 1459, 1485-94 (1979).

62. White Mt. Apache Tribe v. Bracker, 448 U.S. 136, 142-43 n.15 (1980).

63. *Id.* at 137 n.12.

64. Central Mach. Co. v. Arizona Tax Comm'n, 448 U.S. 16, 18 n.4 (1980).