TAXATION WITHOUT COMPENSATION AS A CHALLENGE FOR TRIBAL SOVEREIGNTY

David Y. Kwok[*]

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[*] Assistant Professor, University of Houston Law Center. The author greatly benefited through feedback and encouragement from Mary Kelly Persyn, Lizzy McCloskey, Amy Barsky, Brent Nakamura, Alexa Koenig, and the UHLC Works-In-Progress participants, particularly Jacqueline Lipton, Brett Wells, and Teddy Rave in developing this piece. Thank you also to Veronica Manning for her late stage research and editing assistance, and to the editors of the *Mississippi Law Journal* for their diligent work. Naturally, any remaining errors are the author's alone.

INTRODUCTION

Indian[1] tribes and U.S. states have had ongoing tax conflicts since the 19th century, litigating the question of whether tribes are subject to various state taxes such as income taxes and sales taxes.[2] In this paper, I focus on the dispute over high tax commodities such as cigarettes and motor vehicle fuels. The basic problem is one of overlapping taxation authority. If commodity sales on tribal land are exempt from state taxation, non-tribal members may effectively evade state taxes by crossing into tribal territory and purchasing cigarettes there instead. If tribal sales are not exempt, however, tribes lose an important source of government funding because double taxation of tribal sales places tribal businesses at a competitive disadvantage with businesses subject solely to state taxation. Despite the Supreme Court's attempt to establish "a reasonably bright-line standard which . . . responds to the need for substantial certainty,"[3] litigation over commodity taxation continues across the United States.[4] For

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[1] In this piece, I follow United States precedent in using "Indian" as a legal term of art referring to Native American interests.

[2] *See* McClanahan v. State Tax Comm'n, 411 U.S. 164, 169 (1973) (citing Kan. Indians, 72 U.S. (5 Wall.) 737 (1867); N.Y. Indians, 72 U.S. (5 Wall.) 761 (1867)).

[3] Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 460 (1995) (citation omitted).

[4] *See, e.g.*, Muscogee (Creek) Nation v. Pruitt, 669 F.3d 1159 (10th Cir. 2012); Confederated Tribes & Bands of the Yakama Indian Nation v. Gregoire, 658 F.3d 1078 (9th Cir. 2011); Oneida Nation v. Cuomo, 645 F.3d 154 (2d Cir. 2011); Seminole Tribe v. Fla. Dep't of Revenue, 917 F. Supp. 2d 1255 (S.D. Fla. 2013).

example, the Supreme Court's creation of a legal incidence test intended to provide clear guidance about the limits of state taxation power, but its implementation has resulted in a curious situation; states are forbidden from directly taxing tribal retailers, but states are allowed to force uncompensated tribal retailers to collect taxes on the state's behalf.[5]

I suggest there are two major flaws that have led to the ongoing litigation over these commodity taxes. First, the bright line legal incidence test explicitly and deliberately ignores the reality that commodity taxes have varying impacts on producers, distributors, retailers, and consumers. Measuring the true impact of a tax is challenging, and courts created the legal incidence test to focus narrowly instead on the party legally responsible for paying a tax. Because the legal test differs from the intuitive reality that some tax schemes may be unfair, tribes and judges may facilitate further litigation. Second, because the legal incidence test leads to either the approval or the complete invalidation of a state tax scheme, it becomes a high-stakes affair that tribes may find attractive despite lower probabilities of success. In contrast, if litigation led primarily to small decreases in the rate of taxation, costly federal court battles might be a less appealing option to tribes.

While tribal tax immunity and the legal incidence tests may be valuable in other contexts such as state income taxes, there is a superior solution to the commodity tax conflicts that can reduce litigation and provide more equitable results. Instead of emphasizing tax immunity, I propose that the tribal-state relationship focus upon tax revenue distribution.

The first step to such a plan is a general acceptance of the state's right to tax commodities. In *Wagnon v. Prairie Band Potawatomi Nation*, the Supreme Court acknowledged the state's power to do so via an upstream taxation program.[6] For a number of extra-legal reasons, including the argument that upstream taxation is the most easily administrable taxation scheme, *Wagnon*'s majority opinion is a practical and logical result. I therefore argue that *Wagnon* should be interpreted broadly–as

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[5] *See, e.g.*, Dep't of Taxation & Fin. v. Milhelm Attea & Bros., 512 U.S. 61, 71 (1994).

[6] 546 U.S. 95, 102-04 (2005).

long as states fashion their taxation schemes properly, they should have wide authority to tax commodities even when the final sale occurs on tribal land. This interpretation establishes a clear bright line rule, making it straightforward to legitimate state commodity taxation schemes.

I further argue that the expanded state power authorized by the broad reading of *Wagnon* should be balanced with expanded tribal power. The taxation rights of tribes stem from judicial interpretation of the concept of tribal sovereignty. While tribal sovereignty certainly incorporates the right of tribes to tax their own members and lands, I suggest it should also incorporate a judicially cognizable claim for a portion of state tax revenues. *Wagnon* itself suggests the importance of expenditures in relation to the legitimacy of a tax. I therefore suggest that *Wagnon* only addresses the legitimacy of state taxation; there remains the open question of whether tribes are entitled to portions of the state taxation revenue. The state's collection of a tax does not automatically entitle it to decide unilaterally how those revenues are to be disbursed. Courts can play a key role in encouraging fair, good faith negotiations between tribes and states over the distribution of these tax revenues. Should litigation occur, district courts should carefully consider tribal claims for state tax revenues; these fact-dependent analyses for a fair distribution of tax revenues should be entitled to great deference on appellate review.

I begin with some background on the conflicts between state and tribes on commodity taxation. Next, I discuss the Supreme Court's decision in *Wagnon*, which demonstrates the limits of the legal incidence doctrine in ascribing tribal sovereignty. In Part III, I address some of the potential underlying motivations that may be leading to the conflicts between states and tribes on commodity taxation. In Part IV, I suggest that there is only one taxation scheme that is practically sustainable. Therefore, in Part V, I discuss how courts might reduce conflicts and encourage cooperation between states and tribes. In Part VI, I address some potential concerns with my proposal, and I then conclude.

I. BACKGROUND ON STATE AND TRIBAL TAXATION OF COMMODITIES

The relationship among the tribes, states, and federal government has a detailed history, which I do not presume to summarize here; suffice it to say that the present era has been described as one of self-determination and self-governance–tribal government should be distinct and recognized by state and federal government.[7] This is in contrast to earlier eras, which have focused on, for example, the assimilation of Native Americans as individual U.S. citizens without reference to tribal treaties and lands.[8]

The federal government presently views tribes as governmental entities that are capable of pursuing the welfare of tribe members.[9] The federal courts have labeled tribes as "domestic dependent nations"[10] in an attempt to describe tribal sovereignty, but the doctrine has been criticized as "an inconsistent, paradoxical legal shell" of judicial construction.[11] I do not attempt to untangle the underlying theory of tribal sovereignty here, although I address some potential concerns later in Part VI. For now, federal courts acknowledge that "[t]he power to tax is an essential attribute of Indian sovereignty because it is a necessary instrument of self-government and territorial management."[12] It is also important to note that the modern

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[7] *See generally* COHEN'S HANDBOOK OF FEDERAL INDIAN LAW § 1.07 (Nell Jessup Newton ed., 2012).

[8] *See generally id.* § 1.04.

[9] *See* White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 143 n.10 (1980) (describing congressional intent "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" and "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") (quoting Indian Financing Act of 1974, 25 U.S.C. § 1451 (2012); Mescalero Apache Tribe v. Jones, 411 U.S. 145, 152 (1973)).

[10] Cherokee Nation v. Georgia, 30 U.S. (5 Pet.) 1, 17 (1831).

[11] Sarah Krakoff, *A Narrative of Sovereignty: Illuminating the Paradox of the Domestic Dependent Nation*, 83 OR. L. REV. 1109, 1113 (2004).

[12] Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 137 (1982); *see also* Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 152 (1980).

regime regulating such taxation is primarily a federal judicial creation.[13]

I focus this paper on the practical present regime surrounding state taxation. I look only at the taxation of non-produced commodities, namely cigarettes and motor vehicle fuel. Since the 1970s, Indian tribes and U.S. states have had numerous conflicts over various state taxes impacting Indian tribal business with non-tribal members. The Supreme Court has noted that Congress could exercise statutory or regulatory powers to address the state-tribal tax relationship, but Congress has not done so.[14] The federal courts have therefore developed various doctrines to mediate tax disputes between tribes and states.[15] In particular, the courts have interpreted tribal sovereignty to imply some exemption from state taxation, and this exemption stems from tribal lands.[16] The central questions are thus the "who" and "where" of state taxation. I now review some of the central cases describing the legal incidence doctrine as presently applied.

A. State Taxation of an Indian Tribe on Indian Land Is Generally Impermissible

The Supreme Court has held that states are barred from taxing Indians on income derived wholly from reservation sources or transactions among tribal members on tribal land.[17] "[W]hen a

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[13] See 2 JEROME R. HELLERSTEIN ET AL., STATE TAXATION ¶ 22.07 (3d ed. 2012) for a tax overview. For a tribal sovereignty overview, see David M. Schraver & David H. Tennant, *Indian Tribal Sovereignty–Current Issues*, 75 ALB. L. REV. 133 (2011). *See also* Matthew L.M. Fletcher, *The Supreme Court and Federal Indian Policy*, 85 NEB. L. REV. 121 (2006).

[14] *See* Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 455 (1995) ("The Constitution vests the Federal Government with exclusive authority over relations with Indian tribes . . . , and in recognition of the sovereignty retained by Indian tribes even after formation of the United States, Indian tribes and individuals generally are exempt from state taxation within their own territory.") (quoting Montana v. Blackfeet Tribe, 471 U.S. 759, 764 (1985)) (alteration in original).

[15] *See id.* at 458.

[16] *Id.* at 455.

[17] *See* McClanahan v. State Tax Comm'n, 411 U.S. 164, 168 (1973) (describing "deeply rooted" history of "leaving Indians free from state jurisdiction and control," and thus "state law could have no role to play within the reservation boundaries"); Moe v. Confederated Salish & Kootenai Tribes of the Flathead Reservation, 425 U.S. 463, 475-76 (1976); Okla. Tax Comm'n v. Citizen Band Potawatomi Indian Tribe, 498 U.S. 505, 510-11 (1991).

State attempts to levy a tax directly on an Indian tribe or its members inside Indian country, rather than on non-Indians," the Supreme Court employs "a more categorical" test for the validity of the tax; "'[A]bsent cession of jurisdiction or other federal statutes permitting it,' . . . a State is without power to tax reservation lands and reservation Indians."[18]

The first question for courts, then, is to determine when a state tax on commodities corresponds to a tax on Indians on tribal land. From the perspective of economic reality, the fact that a party pays a tax directly to the government does not mean that the party has less money; the party may be able to pass along the tax to its customers, for example. Consider a gas station selling fuel to consumers at three dollars per gallon before taxes. The state chooses to tax the gas station at one dollar per gallon of motor fuel sold. The gas station may respond in a number of ways. At one extreme, it might continue selling fuel at three dollars per gallon and entirely absorb the tax. Under this scenario, the gas station bears the full economic burden of the tax. At the other extreme, it might raise the price of fuel sold to four dollars per gallon, thus fully passing along the tax to customers. A third choice is a price in between three and four dollars per gallon. Under both of the latter scenarios, customers bear at least some economic burden of the tax originally levied on the gas station. For simplicity, I do not address the factors leading to the gas station's price decision here. Suffice it to say that although a gas station may be assessed a tax on motor fuel, it could pass at least some of those taxes along to customers.[19] The party that finally ends up with less money as a result of the tax bears the economic incidence or burden of the tax.[20]

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[18] *Chickasaw Nation*, 515 U.S. at 458 (quoting Cnty. of Yakima v. Confederated Tribes and Bands of Yakima Nation, 502 U.S. 251, 258 (1992)).

[19] This assumes that customers are at least somewhat inelastic as to the purchase of motor fuel.

[20] This is an oversimplification of economic incidence, as a party may suffer a relative loss in utility rather than a loss of money. For example, if the tax results in the price exceeding the value of the good to the consumer, the consumer simply declines to make the purchase. She does not have less money (actually, she has more having not made the purchase), but she suffers a relative loss of utility in contrast to a world lacking the tax, assuming that she would have enjoyed some consumer surplus had she made the tax-free purchase.

Determining economic incidence is a difficult proposition.[21] The Supreme Court instead wanted "a reasonably bright-line standard which . . . responds to the need for substantial certainty as to the permissible scope of state taxation authority."[22] As a result, courts developed the concept of the legal incidence, roughly corresponding to the party with the legal obligation to pay the tax. Courts have recognized that, "[a]s a general rule for deciphering legal incidence, the United States Supreme Court has instructed that [courts] are to conduct 'a fair interpretation of the taxing statute as written and applied.'"[23] There is no direct relationship between economic and legal incidence, as "[t]he person or entity bearing the legal incidence of the tax is not necessarily the one bearing the economic burden."[24] Courts analyze "the legal obligations imposed upon the concerned parties" rather than "divining the legislature's 'true' economic object."[25] Returning to the gas station example, while the gas station might bear the legal incidence of a fuel tax if it is legally responsible for paying such a tax, it might not bear any economic incidence if it is able to pass along the tax to customers without affecting the customers' purchase levels.

Under the legal incidence doctrine, "[t]he initial and frequently dispositive question in Indian tax cases . . . is who bears the legal incidence of a tax."[26] If the legal incidence of an excise tax rests on a tribe or on tribal members for sales made inside Indian country, the tax cannot be enforced absent clear congressional authorization.[27] Courts have held that "[t]he

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[21] *See Chickasaw Nation*, 515 U.S. at 459-60 (acknowledging that legal incidence might have "no relationship to economic realities," but that economic analysis might be "daunting," requiring consideration of "how completely retailers can pass along tax increases without sacrificing sales volume–a complicated matter dependent on the characteristics of the market for the relevant product").

[22] *Id.* at 460 (citation omitted).

[23] Coeur D'Alene Tribe v. Hammond, 384 F.3d 674, 681 (9th Cir. 2004) (quoting Cal. State Bd. of Equalization v. Chemehuevi Indian Tribe, 474 U.S. 9, 11 (1985) (per curiam)).

[24] *Id.* (citing *Chickasaw Nation*, 515 U.S. at 460).

[25] *Id.* (quoting Crow Tribe of Indians v. Montana, 650 F.2d 1104, 1111 (9th Cir. 1981)).

[26] *Chickasaw Nation*, 515 U.S. at 458.

[27] *Id.*; *cf.* White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 144 (1980) (suggesting that state taxation is generally impermissible under such circumstances because "the State's regulatory interest is likely to be minimal and the federal interest

question of where the legal incidence of a tax lies is decided by federal law."[28]

Legal incidence depends on a variety of factors. Courts may consider whether the statute contains a "pass through" which moves incidence down the distribution chain (i.e. from wholesaler to a retailer or purchaser).[29] They may consider who is compensated for "'collecting and remitting' the tax on behalf of the State" or what invoices show regarding payment of the tax.[30] Courts may evaluate whether a retailer can recoup the tax it paid earlier for product it is later unable to sell,[31] if the retailer is refunded the tax when a consumer fails to pay,[32] and who is penalized for non-payment.[33] As a general principle, "a party does not bear the legal incidence of the tax if it is merely a transmittal agent for the state tax collector."[34]

In *Chickasaw Nation*, the state of Oklahoma attempted to tax motor fuels sold by tribal retailers on tribal land.[35] The Court noted that the Oklahoma tax statute did not explicitly identify who bore the legal incidence of the fuel tax.[36] It noted, though, that the legislation did not contain a "pass-through" provision that required distributors or retailers to pass the tax along to customers.[37] The statute did require fuel distributors to remit taxes "on behalf of a licensed retailer."[38] After mentioning that the distributor could deduct uncollected taxes, the Court concluded that the distributor was a mere transmittal agent and thus did not bear the legal incidence of the tax.[39] Because the retailer was

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in encouraging tribal self-government is at its strongest," thus implying that a balancing test is actually at play).

[28] *Hammond*, 384 F.3d at 681.

[29] *See id.* at 685-86; *cf.* Cal. State Bd. Of Equalization v. Chemehuevi Indian Tribe, 474 U.S. 9, 11 (1985) (per curiam) (stating that there is no "requirement that pass-through provisions . . . be 'explicitly stated'") (citation omitted).

[30] *See Hammond*, 384 F.3d at 686 (citation omitted).

[31] *See id.* at 687.

[32] *See id.* at 687-88.

[33] *See* Wagnon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 103 (2005).

[34] *Hammond*, 384 F.3d at 681 (citing Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 461-62 (1995)).

[35] *Chickasaw Nation*, 515 U.S. at 452-53.

[36] *Id.* at 461.

[37] *Id.*

[38] *Id.* (emphasis omitted).

[39] *Id.* at 461-62.

not described in similar terms in the statute, the Court concluded that the retailer was not a transmittal agent and therefore bore the legal incidence of the fuel tax.[40]

By pursuing this legal incidence analysis, the first method a tribe might use to litigate against a state tax would be to argue that the legal incidence falls impermissibly upon a tribe member on tribal land.

B. State Taxation of Non-Indian Parties on Indian Land May Be Permissible

If a court following the legal incidence doctrine demonstrates that the state tax falls upon a permissible party, the next question is the location of the permissible party. If the permissible party and the transaction are on tribal lands, Supreme Court decisions typically apply some sort of balancing test.[41]

In *Washington v. Confederated Tribes of the Colville Indian Reservation*,[42] the Supreme Court approved a cigarette tax whose legal incidence fell upon the nontribal purchaser. It further held that not only could the state impose such a tax, but it could also impose at least "minimal" burdens on the Indian retailers to enforce and collect the tax.[43] The Supreme Court appeared to use some form of balancing test in weighing the tribal interest in tax revenue against the state's interest in tax revenue.[44] The Court considered the state cigarette tax nondiscriminatory.[45] While the tribes also taxed tribal cigarette sales to nontribal purchasers, the tribal tax was substantially lower than the prevailing state tax.[46] The Court held that the tribal smokeshops were offering nontribal customers "solely an exemption from state taxation."[47] It thus believed that the sole reason nontribal customers came to these

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[40] *Id.* at 462.

[41] *See, e.g.*, *id.* at 459 ("But if the legal incidence of the tax rests on non-Indians, no categorical bar prevents enforcement of the tax; if the balance of federal, state, and tribal interests favors the State, and federal law is not to the contrary, the State may impose its levy.").

[42] 447 U.S. 134, 159 (1980).

[43] *Id.* at 151.

[44] *Id.* at 156-57.

[45] *Id.* at 157.

[46] *Id.* at 154.

[47] *Id.* at 155.

smokeshops was for the lower tax-inclusive price. The state did not give the smokeshops a credit for tribal taxes paid, but the Court noted that the tribes failed to demonstrate the impact of such a hypothetical credit.[48] Implicitly, the Court did not believe that nontribal members would come to these smokeshops to purchase cigarettes, regardless of whether the smokeshops' tax-inclusive prices were equal or higher than those off the reservation.

As a contrast to *Colville*, the Supreme Court in *White Mountain Apache Tribe v. Bracker* struck down state taxes imposed upon a non-Indian business.[49] In *Bracker*, the state of Arizona attempted to apply motor carrier license and use fuel taxes to a non-Indian logging enterprise operating on reservation land.[50] The Supreme Court noted that "timber on reservation land is owned by the United States for the benefit of the Tribe and cannot be harvested for sale without the consent of Congress."[51] In dicta, the *Bracker* Court describes the state taxation of purely tribal affairs on tribal lands as improper due to a comparison of minimal state interests against a strong "federal interest in encouraging tribal self-government."[52] Federal regulation of the timber is "comprehensive,"[53] as "the Bureau of Indian Affairs exercises . . . daily supervision over the harvesting and management of tribal timber."[54] This led the Court to declare,

> There is no room for these taxes in the comprehensive federal regulatory scheme. In a variety of ways, the assessment of state taxes would obstruct federal policies. 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 on Bureau and tribal roads within the reservation.[55]

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[48] *Id.* at 157-58.
[49] 448 U.S. 136, 138 (1980).
[50] *Id.* at 137-38.
[51] *Id.* at 138.
[52] *Id.* at 144.
[53] *Id.* at 145.
[54] *Id.* at 147.
[55] *Id.* at 148-49.

The Court noted that the state taxes interfered with the federal objective of the Indians to receive the benefits of the forest, the Secretary's ability to set fees and rates, and the tribe's ability to comply with mandated sustained-yield policies.[56] The Court further noted that the economic burden of the taxes fell upon the tribe, although it is unclear what role that factor played in the decision.[57] The Court indicated that the state's "generalized interest in raising revenue" was insufficient to permit interference with the federal regulatory scheme.[58] While not an explicit description of a balancing test, the Court appears to have balanced the state's interests against the federal and tribal interests in holding the state taxes preempted.[59]

C. State Taxation of a Non-Indian Party on Non-Indian Land Is Permissible

The most permissive judicial regime is the state taxation of a non-tribal entity not on tribal land. If the courts determine that the party and transaction occur off tribal lands, the state tax is generally permissible. In *Wagnon*,[60] the Supreme Court upheld a sales tax scheme that applied the legal incidence of a fuel tax to the supplier's entry of fuel into the state. Thus, all fuel sold was subject to the tax. Since the tribe purchased fuel from these off-reservation suppliers, it paid a higher tax-inclusive price for fuel.[61] This strategy allowed Kansas to tax effectively all fuel sales on the reservation, as this tax-inclusive higher fuel price would be paid by both tribal members and nontribal members alike. We might conclude that Kansas learned from *Chickasaw Nation* by expressly indicating in legislation that the legal incidence of the fuel tax was on the distributor.[62]

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[56] *Id.* at 149-50.

[57] *See id.* at 151 n.15.

[58] *Id.* at 150.

[59] *Id.* Note also that the *Bracker* preemption doctrine is distinct from other forms of federal preemption. *See id.* at 143 ("The unique historical origins of tribal sovereignty make it generally unhelpful to apply to federal enactments regulating Indian tribes those standards of preemption that have emerged in other areas of the law.").

[60] 546 U.S. 95, 99 (2005).

[61] *Id.* at 99-100.

[62] *See id.* at 102.

Of particular significance is that the Court explicitly distinguished and rejected the balancing test utilized in *Bracker*.[63] *Wagnon* similarly did not follow the balancing test suggested by dicta in *Chickasaw Nation*.[64]

Note also that *Wagnon* was not the first instance of the upstream taxation strategy; the state of Washington applied upstream taxation to cigarettes in *Colville*,[65] and the Supreme Court has endorsed the strategy in other settings.[66]

Thus, the central questions in legal incidence analysis are 1) who pays the tax and 2) where it is paid. While this analysis may appear straightforward, the central elements remain contestable. How did the Supreme Court determine that the upstream supplier was not merely a "transmittal agent" that did not bear the legal incidence of the tax? Is there some point at which a "minimal burden" on a transmittal agent becomes sufficiently great such that the agent actually bears the legal incidence of the state tax? Relatedly, how does the Supreme Court determine the location of a transaction?

I raise these questions not to offer answers, but rather to highlight the possibility that the application of legal incidence could still vary greatly after *Wagnon*. While these decisions purport to draw bright line rules, many of these concepts remain highly contestable.

II. THE LIMITS OF LEGAL INCIDENCE AND ECONOMIC REALITY

Legal incidence has been an attractive test because of its comparative ease in judicial determination. Determining the actual economic burden of a tax requires social science techniques, and the party bearing the economic burden may change over time. If the purpose of legal incidence doctrine is to reduce litigation and

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[63] *Id.* at 110 (limiting application of *Bracker*, which applied a balancing test to determine the validity of tax on a non-Indian enterprise that contracted with the Tribe to harvest timber from reservation forests).

[64] *Id.* at 111 n.5 (limiting application of *Chickasaw Nation*).

[65] *See* Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 141-42 (1980).

[66] *See, e.g.*, Okla. Tax Comm'n v. Citizen Band Potawatomi Indian Tribe, 498 U.S. 505, 514 (1991) ("States may of course collect the sales tax from cigarette wholesalers, either by seizing unstamped cigarettes off the reservation or by assessing wholesalers who supplied unstamped cigarettes to the tribal stores.") (citations omitted).

uncertainty about the appropriate limits of state taxation power over tribes, however, the *Wagnon* decision highlights a number of problems. First, if we read *Wagnon* broadly, there may be no practical limit to the state's power to tax commodities on tribal lands. Second, *Wagnon* continues a line of reasoning on state expenditures that invites uncertainty and litigation.

A. Legal Incidence May Provide No Practical Limitations on State Taxation Power

The decision in *Wagnon* demonstrates the ease with which states can apply commodity taxes to tribes via the upstream strategy. By formally stating that the legal incidence falls upon upstream distributors, states can be assured of judicial affirmation. There is little need to "require" distributors to pass along these taxes to retailers; basic profit-seeking behavior suggests they will attempt to do so.[67] Moreover, *Wagnon* demonstrates that that earlier restrictions on state taxation power are easily circumvented. In *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*,[68] the Supreme Court prohibited the state taxation of tribal-tribal sales. By following the upstream taxation strategy described in *Wagnon*, however, states can effectively tax all commodities on tribal lands that are brought in through the state.

My intention at this point is not to criticize the legal incidence rule's outcome as applied by *Wagnon*; as I discuss in Part IV, there may be no practical and justiciable limit to the state taxation power of commodities. I do find fault, though, with some of the arguments used in *Wagnon* to support the majority's conclusion.

The Court in *Wagnon* conflates multiple arguments regarding the economic consequences of the state's motor fuel

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[67] This assumes a competitive market for distributors dealing with a per-unit commodity excise tax. It is entirely possible that a distributor with market power might not wish to pass the entire tax along due to profit maximization. Determining whether such a distributor had actually failed to pass along the tax would be difficult, however, unless it were to do so in an extremely flagrant fashion by not changing its price at all after imposition of the tax. Most likely, any sophisticated distributor would be smart enough to vary its pricing to obscure the impact and inclusion of the tax.

[68] 498 U.S. 505 (1991).

tax.[69] First, because the tribe owns the gasoline station, the Court discusses how "taxation" and "profits" are indistinguishable. This should not be a consideration, though, since the tribe should be entitled to generate taxes from such transactions regardless of the actual owner of the business. I discuss this point further in Part V.A. Second, the Court further argues that both the tribe and the state should be able to cumulatively tax the same transaction, analogizing to the federal government and the state's ability to simultaneously tax motor fuels and income.[70] Following economic theory, this second argument is misleading and may trigger serious confusion.

There are two independent mechanisms by which incremental taxation could affect the tribe's ability to tax. As a starting point, taxation increases the effective price of the good in question. If demand for the good is perfectly inelastic, then there will be no change in the consumption of the good. Under this scenario, a state tax has no impact on the tribe's ability to tax. The only parties worse off are the consumers; their inelastic demand results in their purchase of the same level of gasoline or cigarettes, but they end up spending more on those goods.

Perfectly inelastic demand is unrealistic, though, as demand generally decreases as prices increase. Important to note, though, is that demand decreases as prices increase for two reasons. First, there is an income effect; as prices increase, consumers simply cannot afford as much of the product as they could before. Second, there is also a substitution effect; consumers might decide that alternative products are more attractive because the taxed good bears a relatively higher price now. I focus here on a particular substitution effect: the availability of a good without the tribe's tax.

This substitution effect is the difference between the state-tribe taxation and the federal-state taxation analogies. A federal tax on fuel applies throughout the country. A consumer cannot escape the federal tax short of leaving the country (and this still depends on border controls and tariffs). Therefore, for customers considering purchase of fuel subject to both federal and state

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[69] *See Wagnon*, 546 U.S. at 114-15.

[70] *Id.*

taxes, the federal tax does not provide an opportunity for the customer to search elsewhere. A customer traveling to another state will still be subject to the federal tax. The greater threat to state taxation is neighboring state taxation; if a neighboring state is readily accessible, the neighbor's decision to not tax or have relatively lower taxes on fuel creates the substitution effect pressure. At some point, if a state is sufficiently small, it may become impossible to tax fuel differently from the neighboring state because every potential consumer could drive out of state to purchase fuel.

Parallel state and tribal taxation of fuel raises substitution effect problems similar to that of neighboring-state taxation. If both state and tribe tax fuel and the tribal stations must levy both taxes, it is relatively easy for individuals to drive off tribal lands and purchase fuel not subject to tribal tax. This substitution effect grows stronger as the ease of driving off tribal lands increases.

Justice Ginsburg recognizes this problem, noting that "[a]s a practical matter, . . . the two tolls cannot coexist [because] . . . scarcely anyone will fill up at [tribal] pumps."[71] Uncontroverted expert testimony similarly suggested that customers were unwilling to pay a premium for gasoline on the reservation.[72]

The broader concern is that courts can only go so far under the construct of legal incidence while disregarding economic reality. As long as states appear to have an effective ability to unilaterally tax commodities on tribal land, it is natural to expect tribes to push back via litigation; recent post-*Wagnon* cases are evidence of this.[73] Furthermore, the high-stakes nature of legal incidence litigation encourages such litigation. The legal incidence test is binary in nature; either a state commodity tax is legitimate or it is a violation of tribal sovereignty. Normally, risk aversion might deter tribes from pursuing such litigation. Under *Wagnon*, however, in which states seem to have a strong unilateral strategy of upstream taxation, tribes may feel they have nothing to lose

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[71] *Id.* at 116 (Ginsburg, J., dissenting).

[72] *Id.* at 126 (Ginsburg, J., dissenting).

[73] *See, e.g.*, Muscogee (Creek) Nation v. Pruitt, 669 F.3d 1159 (10th Cir. 2012); Confederated Tribes & Bands of the Yakama Indian Nation v. Gregoire, 658 F.3d 1078 (9th Cir. 2011); Oneida Nation v. Cuomo, 645 F.3d 154 (2d Cir. 2011); Seminole Tribe v. Fla. Dep't of Revenue, 917 F. Supp. 2d 1255 (S.D. Fla. 2013).

and everything to gain. A win for the tribe results in the invalidation of the state tax; there is no partial win in which the tribe would receive a relatively small award.

B. Justification of Taxes Based upon Expenditures Is Poorly Suited to a Bright Line Rule

Wagnon also highlights a key underlying principle regarding taxation: the justification of taxes based upon expenditures. In *Wagnon*, the Court affirms the Kansas motor fuel tax in part because "Kansas uses the proceeds from its fuel tax to pay for a significant portion of the costs of maintaining the roads and bridges on the Nation's reservation."[74] This principle is equitable and useful, but its application in the legal incidence context may be troubling.

Both the majority and the dissent in *Wagnon* discuss expenses incurred by the state as potential justification of taxation.[75] This is the same argument used in part to invalidate the state taxation in *Bracker*,[76] and the Court has raised this concern in other Indian tax cases.[77] This form of judicial review is troubling for a court interested in bright line rules. The possibility that a state tax is upheld by courts due to specific expenditures made by the state can trigger substantial uncertainty. For example, if the state declines to make those expenditures in the future, does that raise a new opportunity for tribes to litigate and attempt to strike down the tax? The Supreme Court does not explicitly discuss it in *Wagnon*, but does there need to be some level of proportionality between the tax and the expenditures?

I find this doctrinal method of upholding a state tax to be vulnerable to ambiguity and to run counter to the principles supporting bright line tax rules: predictability and justiciability. The facts of costs, expenditures, and actual usage may vary greatly over time; striking down a tax based on those principles seems to create more uncertainty in the tax system.

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[74] *Wagnon*, 546 U.S. at 115.

[75] *See id.* at 115, 129 (Ginsburg, J., dissenting).

[76] *See* White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 148-49 (1980).

[77] *See, e.g.*, Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 157 (1980) (holding that the state's interest in taxation is strongest "when the taxpayer is the recipient of state services").

I am not, however, arguing that this consideration of expenditures be entirely rejected. From a public policy perspective, government expenses must be balanced by revenue typically raised via taxation. I later argue that evaluation of expenditures should be central to resolving disputes over state taxation. For now, I simply suggest that invalidating a state tax because of current state expenditures may be an undesirable judicial rule.

III. PURPOSES OF TAXATION

Wagnon is the latest attempt by the Supreme Court to help address this ongoing state-tribal conflict. I want to take a step back and consider the potential underlying reasons for the conflict. The most basic concern, of course, is that both the state and the tribe have an interest in raising and spending tax revenues. As discussed above, both the majority and the dissent in *Wagnon* discuss how tax revenues may be spent. Important to note, though, is that the raising of revenue is not necessarily the only purpose for establishing a tax. Governments may be also concerned about the incentive effects of taxation; from an economic perspective, taxation can help individuals internalize the external costs of production or consumption. Policymakers might want to discourage gasoline consumption, for example, because the resulting pollution affects people other than the driver of the vehicle, and the driver of the vehicle might not voluntarily reduce her level of driving without the price signal from taxation. Taxation may also have expressive value; even if the tax does not drive individual behavior through increased prices, it may be a signal that society frowns upon particular activities.[78] Taxes on cigarettes and alcohol are often referred to as "sin" taxes.[79] Policymakers may also have the goal of redistribution through taxation: typically to take money away from those who have more and to shift it to those who have less.

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[78] *See, e.g.*, Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021, 2027-28 (1996).

[79] *See, e.g.*, Lee Anne Fennell, *Revealing Options*, 118 HARV. L. REV. 1399, 1482 (2005).

A. Potential Conflicts Arising from the Various Purposes of Taxation

Given the varying purposes of taxation, I suggest we should look at the reasons conflicts may arise over commodity taxation between tribes and states. First, both parties have an interest in raising funds for governance. To some extent, raising government funds is a zero sum game–the more the state collects in tax revenue, the less there is available for the tribe. This form of dispute tends to be subjective and fact intensive; how do we compare the state's entitlement to tax revenues with that of the tribe? Nonetheless, tax revenues may not be strictly zero sum between the state and the tribe–additional revenue may be available at the expense of the taxed parties, too.

Let us look at a hypothetical example. Why would a tribe attempt to place a five percent excise tax on cigarette sales when the state applies a ten percent excise tax? One possibility is that the tribe is competing against the state for cigarette tax revenue; by offering a lower excise tax, consumers pay a lower effective price and are thus induced to purchase from a store under the tribal tax regime rather than a store under the state taxation regime. This competitive strategy was rejected by the Supreme Court in *Colville*.[80]

On the other hand, the offer of a lower excise tax might not be purely competitive in nature. The tribe might have the same goal of maximizing tax revenue, but it may have determined that the elasticity of demand for cigarettes (even ignoring the state's tax rate) was such that it could obtain greater aggregate tax revenues at five percent rather than ten percent. Stated another way, if the tribe could convince the state to lower its excise tax to the same five percent, both the state and the tribe would have more tax revenues in total. This increase in total tax revenue would be attributable to the increased consumption of cigarettes at the five percent tax rate, which would have to be sufficiently high to offset the reduced per-cigarette tax revenue. I label this as a potentially cooperative strategy. While this cooperative strategy is a possibility, if a tribe were to unilaterally set its excise tax at a lower rate, it is difficult to determine how much its increase in tax

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[80] 447 U.S. 134, 155 (1980).

revenue would be attributable to displaced state consumption versus the amount attributable to a better estimate of demand elasticity. A clear demonstration of this cooperative strategy would be an attempt by the tribe to convince the state to match the tribe's lower rate.

Another possibility for the tribe's choice of a lower excise tax rate could be linked to the incentives argument. The tribe may believe, just as the state may believe, that cigarettes should be taxed because of the negative externalities of second hand smoke. Nonetheless, the tribe may estimate the harm from second hand smoke to be less than the state's estimate, resulting in the tribe's selection of a lower tax rate.

A different explanation for the tribe's choice of tax rate might surround the expressive value of the tax rate. The tribe might believe that a ten percent tax rate too strongly condemns the practice of smoking and that a five percent tax rate is a better balance between the governmental interests in tax revenue and the interests of the individual smokers.

Finally, the tribe might choose the lower five percent tax rate because they feel taxation of cigarettes is regressive in nature and that the state is improperly penalizing the poor.

B. The Role of Legal Incidence in Conflict Resolution

Legal incidence doctrine does not directly address the above taxation purposes. Its main value is as a bright line rule that is judicially administrable. Bright line rules for permissible taxation are desirable for at least two reasons.[81] First, there is the ease and cost of administration. States need to know what taxes are permissible; vague limitations may exacerbate conflict and litigation.[82] Second, bright line rules may also be desirable for facilitating negotiation.[83] We might think of bright line rules as a

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[81] *See* Wagnon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 113 (2005).

[82] Uncertainty alone may discourage business and investment. *See, e.g.*, Robert J. Miller, *American Indian Entrepreneurs: Unique Challenges, Unlimited Potential*, 40 ARIZ. ST. L.J. 1297, 1314 (2008).

[83] *See, e.g.*, ROBERT D. COOTER & HANS-BERND SCHÄFER, SOLOMON'S KNOT: HOW LAW CAN END THE POVERTY OF NATIONS 145-46 (2012) (explaining that clear legal rights and outcomes facilitate bargaining); Luize E. Zubrow, *Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 UCLA L. REV. 445, 506 (1994).

method of minimizing transaction costs for negotiations between tribes and states. If parties have greater mutual certainty as to reasonable negotiating positions, they may be more likely to come to agreement. As noted by W. Ron Allen and the Arizona legislature, over 200 tribes in eighteen states have negotiated state-tribal compacts regarding taxes.[84] These tribes and states have negotiated a variety of compacts; some offer tribes all tax revenue stemming from on-reservation sales regardless of purchaser, while others split tax revenue depending on purchaser affiliation.[85]

It is possible, though, that bright line rules might exacerbate conflict and not facilitate negotiations. If the bright line rules seem to defy common sense or provide many openings for refinements and exceptions, these might increase the potential for conflict. Bright line rules that also seem terribly unfair or unjust might similarly spur conflict. Although Justice Ginsburg does not explicitly follow this line of reasoning in her dissent, she does suggest that the *Wagnon* majority's decision may cause more problems from a negotiation perspective.[86]

Determining the true intent of the state or tribe in levying taxes can be a difficult task, analogous to any political, group, or legislative intent analysis. For purposes of this article, I presume that the disputes are primarily around tax revenue. While there are other purposes of taxation, I believe each side is mainly concerned with funding government services for which it requires tax revenues. I also assume that courts are interested in reducing litigation and facilitating negotiation between tribes and states.

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[84] *Tax Fairness and Tax Base Protection: Hearing on H.R. 1168 Before the H. Comm. on Res.*, 105th Cong. (1998) [hereinafter *Hearing*] (testimony of W. Ron Allen, President, National Congress of American Indians) (citing KIM SHEANE ET AL., ARIZ. LEGISLATIVE COUNCIL, STARTED: STATE-TRIBAL APPROACHES REGARDING TAXATION & ECONOMIC DEVELOPMENT 81-105 (1995)), *available at* 1998 WL 373086.

[85] *Id.*

[86] *See Wagnon*, 546 U.S. at 130-31 (Ginsburg, J., dissenting) (noting that the majority position "is particularly troubling because of the cloud it casts over the most beneficial means to resolve conflicts of this order" and that "[b]y truncating the balancing-of-interests approach, the Court has diminished prospects for cooperative efforts to achieve resolution of taxation issues through constructive intergovernmental agreements").

IV. WHICH TAXATION AND JUDICIAL REVIEW SYSTEMS WILL ENABLE PURSUIT OF THESE GOALS?

With these goals in mind, I consider three possible taxation regimes. The first is a parallel, cumulative taxation regime under which both the state and the tribe may tax commodities. The second is a taxation regime in which the state or the tribe may tax a commodity to the exclusion of the other, and the final regime is one in which the state and tribe set the same exact tax on a commodity. I review these regimes in turn, followed by a consideration of the appropriate judicial review process.

A. Parallel, Cumulative Taxation

Under this system, both parties may assess taxes on any commodities; these taxes are cumulative, so the fact that the state charges a ten percent sales tax and the tribe charges a fourteen percent sales tax results in a cumulative twenty-four percent sales tax on commodities. This effectively is the *Wagnon* majority's proposed system.

Assuming that the tribe can only obtain enforcement of tax collection within its borders, this system is harmful to the tribe's ability to raise revenues. Consumers will unilaterally pay a higher tax-inclusive price for commodities within tribal borders, making it difficult for tribal retailers to compete. The tribe will generally be forced to attract customers via alternative mechanisms, such as the casino described in *Wagnon*, although, as suggested by the record in *Wagnon*, casino visitors may be unwilling to purchase gasoline or cigarettes at a premium.

To the extent that the tribe disagrees with the state's estimate of demand elasticity, this parallel concurrent system offers no benefits. No consumers will actually face the lower tax-inclusive price the tribe believes is a superior policy option, as all sales will include the higher state tax, too.

There is no advantage from an incentives perspective, unless we believe that governments (state, federal, and tribal alike) systematically underestimate the negative externalities due to commodity consumption. If all parties systematically underestimate, perhaps there is some benefit in making all taxes cumulative.

The expressive value of tribal taxes is unclear under this system. While the tribe's tax rate might be lower than the state's tax rate, customers must still pay both taxes. If the tribe already believed that a ten percent tax rate was an excessive condemnation of cigarette consumption, it may be difficult to claim that the tribe's support of an additional, cumulative five percent tax rate results in less condemnation. Nonetheless, if the tribe continues to argue that the state's tax rate should not apply, there is perhaps expressive value in the tribe's decision to apply the five percent tax rate.

There is no redistributive value in this system for the tribe, unless the tribe believed that commodity consumption was insufficiently taxed for purposes of redistribution. Even if the commodity were insufficiently taxed, however, the ease of evasion of the tribal tax by making purchases off-reservation will likely circumvent any redistributive value of the tribe's additional tax.

B. Exclusive Taxation

An alternative is to allow tribes and states to tax commodities separately but to not make the taxes cumulative. Thus, a tribe could place a five percent tax on cigarette sales while the state applied a ten percent tax on cigarette sales. If a consumer purchased the cigarette on tribal lands, she would pay a five percent sales tax. If she were to purchase the cigarette off-reservation in the state, she would pay a ten percent sales tax. This roughly was the situation before *Wagnon* under *Colville*,[87] although in principle, only tribal customers could benefit from the tribal sales tax–non-tribal members legally owed the state tax on cigarettes purchased on reservation.

In theory, this system allows both tribes and states to pursue the various tax interests described earlier. The main problem with this proposal is the high potential for the competitive tax strategy. It is generally easy to cross reservation borders, and if the tax differential is high enough, the tribe could obtain cigarette sales solely by way of the lower tax-inclusive price. These tax differential problems across international borders are usually

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[87] Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 154-55 (1980).

addressed via border controls and tariffs, but these are impractical solutions for tribal-state boundaries.

From an empirical perspective, the prevalence of this competitive tax strategy is unclear. Tribes already have challenges in attracting non-member visitors and business to tribal lands with perhaps the exception of gaming facilities. Nonetheless, the Supreme Court disapproved of the competitive tax strategy in *Colville*.[88] Furthermore, in *Colville* it allowed states to place at least "minimal burden[s]" on tribes in enforcing these taxes,[89] but the effectiveness of these burdens in reducing competitive tax strategies may be in question. Overall, the problem of porous borders and competitive tax strategies may dwarf any potential gains in vindicating non-revenue purposes of taxation.

C. Same Tax Level, Non-Cumulative Taxation

I suggest there is only one practical taxation scheme: one in which the tribe and state set the same commodity tax level.[90] Customers thus pay the same commodity tax regardless of the location of purchase. Assuming that the commodity market is otherwise competitive, customers pay the same tax-inclusive price everywhere. This minimizes the risks of competitive taxation. This scheme fits well with the upstream taxation method, which is probably the most efficient method in terms of collections and auditing. Numerous tribes and states have negotiated such arrangements.[91]

The tradeoff is the lack of ability for the tribe to utilize taxation independently for the other purposes described. If the tribe has a say in the state's taxation level, it may be able to pursue various taxation goals. To the extent the tribe can apply higher taxes than the state, it may still have some ability to handle redistribution. Market forces–the choice of consumers to avoid those higher taxes by going to shops on state land–may render that strategy ineffective, though. Assuming this scheme

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[88] *Id.* at 155.

[89] *Id.* at 151.

[90] It may be similarly fine for the tribe to agree to a higher tax rate than that of the state, but I do not see evidence of tribes attempting to do so in reality.

[91] *Hearing*, *supra* note 84.

generally encourages improved negotiation between tribes and states, though, it at least improves the possibility that some of the other interests supported by taxation could be vindicated through variation in negotiated agreements.

Supporting this strategy allows courts and society to emphasize two general principles. First, tribes should not be allowed to manipulate commodity tax rates to obtain greater tax revenues at the expense of the state. This is something that is relatively easy for courts to identify and discourage. Second, tribes and states should be able to negotiate fair distributions of tax revenues. Determining fair distributions is a fact-intensive process that does not lend itself towards appellate judicial analysis.

Furthermore, this proposal encourages predictability in the assessed taxation scheme. Businesses and customers will face less uncertainty and variation as to the taxes they owe on commodity purchases.[92] This enables better business planning and requires less attention to ongoing litigation and legislative proposals.

V. THE ROLE OF THE COURTS

Given the judicial deference to Congress in matters of state-tribal taxation, the easiest implementation of this tax scheme would be via federal statute. Thus far, though, Congress has not issued any formal guidance, leaving these state-tribal taxation conflicts to the courts. Even without Congressional action, courts can execute this proposal post-*Wagnon*. The current balance of state and tribal tax powers is a judicial development of the concept of tribal sovereignty. I propose that courts extend the concept of tribal sovereignty to grant tribes a special claim to state tax revenues. This is distinct from the concept of tribal sovereignty as granting immunity to state taxation.

First, I suggest reading legal incidence under *Wagnon* broadly. In practical terms, I believe legal incidence analysis is a trivial exercise–it should be straightforward for states to pass tax laws following *Wagnon* that do not trigger legal incidence issues. The main remaining test is that of impermissibly discriminatory taxation. The test as outlined in *Wagnon* is sufficient; if there is

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[92] *See* Miller, *supra* note 82, at 1314.

some reasonable explanation for the state's tax, namely the state's maintenance of infrastructure leading to tribal assets, then the state tax is acceptable.[93] States should not discriminate against tribes, but the *Wagnon* standard for discriminatory taxation is rather easy to satisfy. Moreover, because of my proposed tribal sovereignty claim on state tax revenues, tribes can later negate the impact of borderline discriminatory taxes by claiming the resulting revenues.

Courts should read the core of *Wagnon*, though, as an analysis of the *legitimacy* of state taxes; when should the court strike down a state commodity taxation scheme? As implied by both *Wagnon*'s majority and dissent, expenditures incurred by parties are relevant to analysis. I suggest that *Wagnon*'s discussion of state expenditures is sufficient for purposes of legitimacy, but there is an unresolved question of state expenditures in the context of the distribution of state tax revenues. Furthermore, I argue that *Wagnon* and its predecessors fit within a judicial review structure that includes a tribal sovereignty claim for a portion of state tax revenues. Thus, while the state is certainly free to impose a dollar per gallon excise tax on all motor fuel entering the state under *Wagnon*, there is still an open question as to how those tax revenues will be allocated.

A. A Limited Class of Inappropriate Tax Revenue Usage

The *Wagnon* opinion already discusses expenditures related to tax revenues.[94] The Supreme Court generally describes expenditures as being relevant to allowing taxation; the fact that a party incurs expenses related to the market for the good helps legitimate a tax. I argue, however, that there should be prohibited uses for taxes; artificially supporting a business or using the money as a rebate, coupon, or promotion for the sold good are inappropriate activities that must be rejected. This usage of tax revenue is analogous to improper competition via tax rates.

This restriction should be narrowly construed, though. There may be a variety of expenditures that may be in support of a business. For example, the construction of a nearby casino or

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[93] *See* Wagnon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 115 (2005).

[94] *Id.*

other amenities may serve to attract customers to a gasoline station.[95] Nearly any expenditure by a tribe might be interpreted as a support for tribal businesses, as the attractiveness of tribal lands as a destination could bring in more customers to any tribal business. Moreover, the tribe itself might own businesses, similar to the tribally owned gas station in *Wagnon*.

I suggest that these forms of subsidy are acceptable, though, as they do not have as direct of an impact upon the sale price of the good. Tribes already have enough challenges in attracting non-tribal customers to its lands.[96] Allowing a broad restriction would similarly complicate analysis of state expenditures. I argue that the offense is limited to the marketing of an effectively reduced price good; as long as the facility continues to sell the commodity at a market competitive price, there is no harm from these forms of subsidy.

B. A Tribal Claim on State Tax Revenues

Thus far, I suggest that a broad reading of *Wagnon* should make the legitimation of state tax schemes easier; most states should be able to tax commodities easily under *Wagnon*'s legal incidence application. I propose that the superior channel for tribal concerns is via the distribution of those resulting tax revenues.

The Supreme Court's focus on state expenses in *Wagnon* implies some recognition of benefit theory in taxation. Scholars have noted that "[u]nder benefit theory, a just tax distributes the tax burden in accordance with the distribution of governmental goods and services."[97] Since a state is incurring expenses connected to the delivery and consumption of the fuel, it is entitled to recoup some of those expenses from the party benefiting from the fuel. A logical conclusion, then, is that a tribe may similarly be entitled to recoup some of its expenses connected to the delivery and consumption of the fuel.

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[95] *Id.* at 126 (Ginsburg, J., dissenting).

[96] *See* Miller, *supra* note 82, at 1317-18 (describing typical geographical isolation of Indian lands).

[97] Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 LAW & POL'Y INT'L BUS. 145, 157 (1998).

I thus propose that the federal courts may be ready to recognize a tribal claim for a portion of state commodity tax revenues under its tribal sovereignty doctrine. This tribal sovereignty claim would be a unique claim; normal taxpayers cannot unilaterally demand some portion of tax revenues. Tribal government, however, has a unique, federally authorized responsibility to help restore Indian independence and self-sufficiency;[98] tax revenues are an essential part of this equation. Ideally, this claim would simply be negotiated between the state and tribe.[99] There are, of course, various principles that might come into play in determining fair shares of tax revenue;[100] I do not claim to cover them comprehensively here. As an example, though, states have signed agreements with each other regarding the distribution of motor fuel taxes in the International Fuel Tax Agreement (IFTA).[101] Under IFTA, U.S. states and Canadian provinces collect motor fuel taxes which are effectively paid by truck operators, but those operators use the fuel to travel through various jurisdictions. The operators file reports documenting their interstate and interprovincial travel, and the jurisdiction which originally collected the motor fuel taxes must distribute those revenues based upon the operator's mileage and consumption reports.[102] Tax revenue distribution here is based on a relatively simple principle, mileage driven. Even on such a simple principle, reconciliation of taxes requires substantial documentation from both states and the operators. An analogous regime between tribes and states could focus upon mileage driven upon tribal lands; the challenges for such a regime would be the level of

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[98] *See* White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 143 n.10 (1980).

[99] Various tribes already have tax-sharing or refund agreements with states. *See Motor Fuels Tax Refunds*, WINDOW ON ST. GOV'T, http://www.window.state.tx.us/taxinfo/refunds/fuels/index.html (last visited Sept. 17, 2014); Tax Agreement Between the Saginaw Chippewa Indian Tribe of Michigan and the State of Michigan (Dec. 17. 2010) [hereinafter *Tax Agreement*], *available at* http://www.michigan.gov/documents/taxes/SaginawChippewa_AgreementandAppendix_354550_7.pdf.

[100] For example, ability to pay may be an important factor in determining who should bear commodity related costs. *See Tax Agreement*, *supra* note 99.

[101] *See generally* INT'L FUEL TAX ASS'N, INC., http://www.iftach.org/ (last visited Sept. 17, 2014).

[102] *See, e.g.*, COMPTROLLER OF MD., IFTA COMPLIANCE MANUAL ch. 5 (2012), *available at* http://taxes.marylandtaxes.com/Business_Taxes/Business_Tax_Types/Motor_Fuel_Tax/Tax_Information/IFTA/IFTA_Compliance_Manual/Chapter_05.pdf.

documentation that both sides would find acceptable and not unduly burdensome. As noted above, a distribution based on driven miles does not fully capture all of the costs that a social planner might find relevant in determining a fair distribution of revenues. For example, the amount of pollution and wear caused by motor vehicle traffic does not correspond perfectly to miles driven; irregular, poorly maintained roads might lead to higher levels of auto emissions in one area. Similarly, in the cigarette context, basic location of consumption of cigarettes might lead to healthcare costs that do not correspond directly to the local area–hospitals and health insurance premiums may be funded or located elsewhere. A proper distribution of revenues is a highly fact-intensive affair.

As a result, it is likely that parties presently may be unable to agree to terms as to the distribution of the tax revenues. The courts will play a critical role in helping guide this process, but the temptation to set bright line rules as to appropriate revenue distribution may be troublesome. While I do not provide a comprehensive solution as to the proper determination, I suggest that courts must structure decisions to provide room for negotiation between tribes and states. Bright line rules in the form of *Wagnon*'s legal incidence test, for example, that simply shift all of the negotiating power to the state do not facilitate equitable negotiated results. Courts should certainly be aware of improper tax revenue usage as noted above. It may also be appropriate to consider expenditures in resolving tax revenue distribution. Although it may seem tedious, a detailed analysis is important to avoid skewing the balance of power in pre-litigation negotiations. The base assumption, though, could be that parties are entitled to the tax revenues stemming from consumer transactions on their land. Both parties are free to argue how various costs should come into play in dividing up the aggregate tax revenues. Resulting legal decisions would be fact-specific and of little precedential value, which hopefully would deter strategic litigation.

Again, this distribution of revenues does not affect the legitimacy of the state and tribal taxes; this avoids the unpleasant situation in which a tax loses legitimacy due to a change in

expenditures. All that is fought over at this point is distribution of the ensuing tax revenues.

C. Limits to the Tribe's Ability to Claim Tax Revenues

Allowing tribes to make a claim on state tax revenues could open the door for a wide variety of claims. The routine claim would be the state's taxation of cigarettes purchased by tribal members from a tribal retailer on tribal land. Under *Wagnon*, this transaction can be taxed upstream by states. Tribes must be able to make a claim for these taxes if they are to be able to obtain any tax revenues from those products.

On the other hand, what happens to a tribal member who leaves tribal lands, drives to a retail store in the state, and purchases a pack of cigarettes? The tribal member's purchase is ordinarily subject to state taxation. Could the tribe apply a claim to that revenue?

I suggest that the answer is yes. We can imagine all sorts of commodities that would be taxed by the state. The state could ostensibly tax any commodity on a non-discriminatory basis; it levies the same tax for tribal and non-tribal customers. Nonetheless, the practical effect might be a disproportionate impact on the tribe if the tribe is the primary consumer of the commodity. Allowing the tribe to make a claim for the resulting tax revenues provides judicial review for state taxation schemes that may be creative discriminatory schemes.

Adding complexity are taxes on profits or on some non-per-unit tax that would impact commodity prices. I do not address the wider variety of state taxation schemes in this paper, but there are other state taxes, such as business registration fees, that may be contested. For example, in *Bracker*, the state applied taxes on trucks hauling timber that had been harvested from tribal lands.[103] It may be that the existing legal incidence framework is sufficient to address these other tax schemes, and I do not have a comprehensive answer at this point. My initial reaction is that courts should be suspicious of such taxation schemes and make every effort to determine whether they are discriminatory in nature. As a parallel measure, allowing tribes to make a claim on

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[103] 448 U.S. 136, 139-40 (1980).

such tax revenues may help alleviate problems that could be caused by such indirect taxation. Furthermore, allowing tribes to make revenue claims would avoid further line-drawing problems in establishing limits to non-discriminatory state taxes.

VI. REACTIONS

I am confident states and tribes will continue to find creative tax and revenue strategies; hopefully the judicial system will encourage the two sides to sign tax compacts that will minimize ongoing conflicts. Besides the basic commodity tax schemes I described earlier in Part IV, I now address some alternative potential concerns with this proposal.

A. Diminishment of Tribal Sovereignty

Perhaps the greatest immediate concern with this proposal is that it may amount to a weakening of tribal sovereignty. Under the status quo, tribes might instead choose to continue fighting on the legal incidence front. They may be unwilling, for example, to give up on the ability to compete on the basis of commodity tax advantages. To some extent, it may be unfair that states, particularly the geographically smaller ones, can compete for local retail customers on the basis of reduced sales tax, while tribes do not have a similar right. Unfortunately for the tribes, courts have not looked favorably upon tribes marketing the sales tax advantage,[104] and Congress has similarly discouraged such activity through the Prevent All Cigarette Trafficking Act.[105]

A related line of argument is that continuing to fight on the legal incidence front regarding commodity taxation could broadly support tribal sovereignty in areas of state taxation outside commodities such as income taxes and business taxes; perceived capitulation on the issue of legal incidence for commodity taxation might weaken tribes overall struggle against encroaching state taxes. Addressing the broader question of general tax jurisdictions between states and tribes is outside the scope of this piece, but as

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[104] *See supra* Part I.

[105] *See* Associated Press, *U.S. Law Didn't Halt Untaxed Tobacco Sales*, BOSTON GLOBE (Dec. 2, 2013), http://www.bostonglobe.com/news/nation/2013/12/02/law-didn-halt-cigarette-flow-from-tribes/0gLQZPru5w8mBxTc0lfBWN/story.html.

noted above, the tribes do not seem to be winning the commodity taxation fight either in the courts or in Congress. I suggest that it may be just as likely that court losses in the commodity taxation arena may be dragging down tribal sovereignty in other areas.

Tribal sovereignty is essential to the present state of Native American peoples; whether this proposal constitutes a diminishing of tribal sovereignty depends in part on definitions. If sovereignty is the freedom to set tax rates without constraint, tribes suffer some loss–they cannot unilaterally set a lower commodity tax rate to undercut the state tax. Nonetheless, tribes may have effectively lost this freedom already given the *Wagnon* upstream taxation strategy for states. If sovereignty instead is the ability to gain and spend tax revenues, this proposal may increase tribal sovereignty. If tribes presently have no real ability to pursue the other purposes of taxation, focusing on the ability to gain revenues may be a gain for tribal governance and sovereignty. By decoupling the process of taxation and assignment of tax revenues, it is possible that tribes may actually gain greater tax revenues by cooperating with states. This form of sovereignty may be as important as sovereignty tied to land usage, given the often low productive quality of reservation land and the modern service economy growth. If tribes pursue greater economic growth and self-sufficiency through increased trade and inter-dependence with extra-tribal entities, a focus on generalized tribal claims as opposed to tribal lands may be a superior long term strategy.

Moreover, other understandings of tribal sovereignty may be improved by reducing the focus upon commodity taxation; for example, there may not be strong cultural significance to the consumption and resale of motor vehicle fuels.[106]

B. Reduction of Positive Incentives from Status Quo

Separate from the tribal litigation efforts is a concern for the arguably positive incentives within the present regime. For

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[106] *See* Krakoff, *supra* note 11, at 1191 (providing a summary of various perspectives on non-legal sovereignty); *see also* L. Scott Gould, *The Consent Paradigm: Tribal Sovereignty at the Millennium*, 96 COLUM. L. REV. 809, 810-11 (1996) (discussing inherent versus consent sovereignty); Hope M. Babcock, *A Civic-Republican Vision of "Domestic Dependent Nations" in the Twenty-First Century: Tribal Sovereignty Re-Envisioned, Reinvigorated, and Re-Empowered*, 2005 UTAH L. REV. 443.

example, the states' current power to tax non-produced commodities creates an incentive for tribes to reduce reliance upon simple trade in commodities and instead to focus upon greater value creation. Rather than simply buying cigarettes from national manufacturers and retailing those cigarettes on tribal land, tribes have greater incentive to purchase tobacco and manufacture cigarettes themselves and thus avoid state taxation on the cigarettes.

In response to this, I suggest that this model of development is unlikely to take hold in the motor fuel context. It seems unlikely that tribes actually have an interest in building refineries on tribal land, and while there may be some tax advantages in doing so, the ancillary pollution and inefficiencies of additional refineries will weigh against such action. In a broader development context, we might be suspicious of industries that are driven primarily by taxation disparities. Given the other purposes of taxation, the externalities of motor vehicle fuel consumption and cigarette consumption are likely similar for tribes and state governments; the availability of such products with lower taxes may not be in society's interest. As a third point, tribes are still subject to state taxation for materials crossing their borders, which continues their vulnerability even if the tribe should choose to switch towards a manufacturing "avoidance" scheme. In the example of tribal cigarette manufacturing, the state could broaden the focus of its taxes from not only cigarettes but also the components and support structures necessary for cigarette manufacturing. Following this strategy, states may be even more capable of creating facially non-discriminatory tax regimes in which tribes bear a disproportionate burden. For example, if tribes are the only parties who engage in the manufacture of cigarettes within a state, the state might tax raw tobacco or other cigarette manufacturing components without any harm to non-tribal entities.

C. Redistribution Rather than Reduction of Litigation

A third concern could be that this proposal may not reduce the resources committed to litigation; instead, it might shift litigation onto the question of distribution of tax revenues. It is, of course, possible that the decades of litigation over legal incidence

doctrine might simply be replicated in the area of tax revenue distribution. I suggest, though, that claims for tax revenues will be quantitative, fact-intensive discussions about tribal and state budgets. I believe appellate courts will be inclined to be highly deferential to trial courts in these decisions, so there should be a reduction in the level of appeals. This is likely because of appellate aversion to detailed quantitative and budgetary reviews. Moreover, the lack of strong remedies such as the wholesale invalidation of a certain state tax will reduce the stakes available on appeal; the parties will likely only perceive small marginal benefits from appeals. Thus, regardless of risk aversion, rational parties will tend to limit appellate litigation expenditures.

D. Border Controls

Finally, one broad alternative solution to these commodity tax concerns is border controls. If the state-tribal boundaries were to have effective border controls, differential levels of taxation between the state and tribe might not be as great of a problem. Border controls, however, are costly to maintain and patrol. Moreover, greater border controls may also further isolate tribal communities from the broader U.S. society. Tribes already have challenges in attracting people and investments to tribal lands; border controls may be another barrier to greater economic development and self-sufficiency for tribes. From a doctrinal perspective under *Wagnon*, states have little incentive to pay for border controls if they can simply utilize upstream taxation to gain revenue from all commodity sales. I do not see aggressive border controls as a likely alternative.

CONCLUSION

As described in *Wagnon*, the judicially created concept of legal incidence has lost its value as a constraint on state-tribal taxation of commodities. I suggest that Congress and courts recognize this economic reality and revisit the concept of tribal sovereignty. First, I encourage Congress and courts to show special deference to state-tribal compacts in which the tribes agree to match the state's level of commodity taxation. This matched taxation rate minimizes the possibility of competitive tax

strategies and is a practical equilibrium. Second, I suggest courts expand tribal sovereignty to incorporate a claim on a portion of state tax revenues rather than solely emphasizing partial immunity to state taxation. Instead of disputing the state's ability to tax, this interpretation of tribal sovereignty gives tribes the judicially enforceable right to make a claim to some portion of the state's resulting tax revenue. By eliminating disputes over the state's ability to tax, appellate courts can reduce uncertainty for business and customers in providing consistent tax rates.

Future work might include broad empirical analysis of the determinants of successful state-tribal negotiations. Some states such as New York have had a long history of cooperation with tribes regarding taxation; it could be helpful to isolate judicial, social, and organizational factors that have contributed to cooperation rather than litigation. Some variation of interest would be states that have come to differing agreements with different tribes in its borders. Also of particular interest would be any tribes that have been able to negotiate with multiple states, as those cases might shed some light on the comparative negotiating ability of states and tribes. There may be other useful parallels in state-state negotiations, particularly in the geographically dense Northeast United States.

Other future work would also take a more comprehensive analysis of taxation and revenue for tribes and not be limited to this paper's focus on taxation of commodities. On one end, as Justice Ginsburg noted in *Wagnon*, tribes may add value to commodities by selling them in proximity to complementary goods and services.[107] Should courts consider the amount of value added to commodity sales in determining whether they are subject to state taxation? Tribes may also push towards production of commodities and services. As tribes move towards online provision of loans, for example, should states have the capability of taxing such transactions? The traditional tie of sovereignty to the physical land of the reservation steadily loses meaning given the various transactions utilized by modern tribes.

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[107] *See* Wagnon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 126 (2005) (Ginsburg, J., dissenting).