Committee on Resources

Witness Statement

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Allow me to express my gratitude to Mr. Chairman Young and Members of the Committee on Resources of the U.S. House of Representatives. I thank you for inviting me to speak on the subject of collection of state transaction taxes relating to cigarettes and motor fuels by retail enterprises operating on lands held in trust for Indian tribes.

The Focus of this Hearing

This hearing arises out of the concern that federally recognized Indian tribes and their members are failing to comply with state laws that impose a tax collection and payment duty on them in those limited cases where a state can lawfully impose a tax within Indian Country. H.R. 1814 is a bill designed to impose sanctions on tribes and their members in cases of non-compliance with their duties to collect and pay state taxes. In addition, two national associations representing gasoline and convenience store retailers have expressed a concern that non-compliance with state laws imposing a tax collection and payment requirement on tribes and their members. These organizations believe that non-compliance creates a de facto tax exemption that causes unfair competition. These associations propose the enactment of federal legislation requiring the Department of Justice, in cases where a tribal enterprise or member-owned enterprise fails to collect state tobacco and fuel excise taxes, to step in and collect these taxes and to pay them over to the specific tribes.

My Background

I have been working in the area of taxation in Indian Country since 1977 when I worked as a summer intern for the IRS in St. Paul, Minnesota and assisted in a federal income tax case involving the Chairman of the Red Lake Band of Chippewa Indians. During 1985 I served as a consultant to the Navajo Tax Commission, during which time I drafted the procedural regulations under the Navajo Nation's tax code and conducted

professional training for the members of the Navajo Tax Commission. During 1986-87 I served as Professor-in-Residence for Chief Counsel's Office of the Internal Revenue Service and worked on a variety of Indian tax projects. In 1989 I began teaching a seminar on Taxation in Indian Country at the University of New Mexico School of Law and continue to teach that course regularly. Over the years, I have served in a pro bono capacity for the Navajo Tax Commission, the Red Lake Band of Chippewa Indians, Santa Clara Pueblo, and the Isleta Pueblo Court of Tax Appeals. In May of 1999 Kelsey Begay, the president of the Navajo Nation, nominated me to serve as a commissioner of the Navajo Tax Commission, and in June of 1999 the Navajo Tribal Council, upon the recommendation of its Government Services Committee, appointed me as one of five commissioners of the Commission. In July the Navajo Tax Commission recommended to the Navajo Nation Tribal Council the adoption of a motor vehicle fuel excise tax of $.18 per gallon on all sales by motor vehicle fuel retailers doing business within the boundaries of the Navajo Nation, which includes portions of New Mexico, Arizona, and Utah. In August the Navajo Tribal Council adopted the proposed tax legislation. In the seminar that I teach at the University of New Mexico, the students spend substantial time studying state and tribal gasoline and cigarette excise taxes.

A Brief History of State Taxation within Indian Country

Most states historically and currently have been very aggressive in their attempts to impose their taxes within Indian Country. Two Supreme Court cases from the middle of the 19th century, The Kansas Indians, 72 U.S. 737 (1866) and The New York Indians, 72 U.S. 761 (1866) demonstrate that states availed themselves of the earliest opportunity to try to impose their taxes within Indian Country. In both the Kansas and New York cases, the Supreme Court reiterated the well accepted principle that states have no taxing authority over tribes, their lands, or their members (within Indian Country) unless and to the extent the Congress may have otherwise authorized such state taxation.

Congress has long recognized that state taxing authorities, like most governmental taxing authorities, tend to "tax now and ask questions later." Accordingly, Congress began affirmatively banning state attempts to tax tribes by explicitly stating the ban in the federal enabling legislation creating the state. See, e.g., The Enabling Act for New Mexico, ch. 310, 36 Stat. 557 (1910). Just a few years ago, the Supreme Court reiterated the now venerable legal principle that states cannot impose their taxes on tribes (or their members) for activities within Indian Country. Oklahoma Tax Commission v. Chickasaw Nation, 515 U.S. 450 (1995) (Oklahoma could not impose its gasoline excise tax on sales of gasoline by a tribally owned gas station located within Indian Country).

In the case of state taxation of non-members, the Supreme Court has held that states may impose their taxes on transactions occurring within Indian Country unless the tax is preempted by federal legislation. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163 (1989). To distinguish between a tax imposed on a tribe (or one of its members) and a tax imposed on a non-member, the Supreme Court has developed its legal incidence test. Chickasaw Nation at 458-59. When the legal incidence of a state tax falls on a tribe or one of its members and involves activities within Indian Country, then the state tax is categorically invalid unless authorized by Congress. Contrariwise, when the legal incidence of a state tax falls on a non-member, even though the transaction takes place wholly within Indian Country, the state tax is valid unless Congress bans it through the preemptive power of federal legislation. Chickasaw Nation at 458.

When a state imposes a valid tax on a non-member, it may place the duty of collecting and paying the tax on the tribe or one of its members. Congress has long used this technique in connection with the collection and payment of income and FICA taxes on employee wages. Congress imposes the legal incidence of these

taxes on the employee but puts the burden of initial collection and payment of these taxes on the employer. IRC §§ 3401-3406 (1999). In the case of tribes, a problem arises because states have no power over tribes unless and to the extent Congress has granted power to the states. The Supreme Court has held that the state may legally impose the duty of tax collection and tax payment on a tribe or one of its members if the process is merely a minimal burden. Moe v. Salish & Kootenai Tribes, 425 U.S. 463, 481-82 (1976). But even when a state validly imposes a tax collection and tax payment requirement on a tribe, a state cannot sue the tribe to collect the unpaid tax from a tribe because a tribe enjoys sovereign immunity. Citizens Band of Potawatomi Indian Tribe v. Oklahoma Tax Commission, 498 U.S. 505, 510 (1991). Tribal officials and individual members, however, enjoy no sovereign immunity. Id.

The Tax Collection Problem

Applied to Tribes

Within the United States, as a matter of federal and state law, tribes are governments having complete sovereignty except as reduced by treaty, federal legislation, or necessary implication of their status as tribes. As governments, tribes are entitled to an appropriate level of intergovernmental respect and deference. As a result, Congress should be very wary of remedying state tax collection problems through sanctions against tribes.

I know of no concrete evidence showing that substantial amounts of tax revenue are being lost by states due to tribes' non-payment of valid state taxes. Most of the claims I have heard concerning lost revenues involve state taxes that are not actually imposed, are not valid, or are legally questionable given substantial ambiguity in the federal and state law.

For example, some people have asserted that New Mexico has lost large cigarette excise tax revenues and gross receipts taxes on sales of cigarettes by tribal smoke shops. There really is no lost tax revenue because New Mexico's cigarette excise tax specifically exempts sales by tribes. Moreover, the gross receipts tax does not apply because its legal incidence falls on the tribe, thereby making it invalid as a matter of federal law. In the case of the gross receipts tax, New Mexico is unlikely to change the legal incidence because such a change would cause huge amounts of lost tax revenues that are currently imposed on contractors dealing with the federal government. If New Mexico shifted the legal incidence of its gross receipts tax on to the consumer, then, in the case of federal contractors, the tax would fall on the United States and would be illegal under McCulloch v. Maryland, 17 U.S. 316 (1819).

In many other cases, the actual validity of the tax is in question. The legal incidence of a tax is often unclear. Many times the status of the land where the transaction takes places is uncertain and may affect the state's power to tax. Possible federal preemption is also difficult to determine because the federal statutes themselves usually are silent about the effect they have on state taxation.

My own experience with tribes shows that they are inclined to comply with state withholding and payment requirements when the taxes are legally imposed and reasonably applied. Gaming tribes with large numbers of employees appear to be in substantial compliance with state income tax withholding and payment requirements.

When there are instances of non-compliance, states are not without remedies. It is a fairly common practice for states to use administrative collection methods for assets located off the reservation. These state tax seizures most often involve tribal bank accounts and involve seizure of sums sufficient to pay the delinquent

taxes.

The remedy proposed in H.R. 1814 is clearly too severe. Under that Bill, a tribe certified to be in non-compliance would have its land removed from federal trust status. The loss of trust status would reduce federal funding and could expose the land itself to seizure by the state and to state property taxation. The loss of trust status may also diminish the tribe's reservation. When states are in non-compliance with their federal tax withholding requirements or the withholding requirements of other states, the federal government does not step in and begin reducing the non-compliant state's political boundaries. Instead, parties work out the difficulties through a variety of less severe means.

The remedy proposed by the coalition of convenience store and gasoline retailers is not a desirable solution either. Under their plan, the federal government would step in as collection agent, deduct a fee for administration, and pay the collected tax over to the tribe. A variety of problems face this plan. First, the legal uncertainty that abounds in this area will make the federal government's collection role very difficult because some taxes will be invalid and others arguably invalid. Thus far, the litigation on the validity of state taxes within Indian Country has been extensive and not especially favorable to states. And the pace of litigation on these questions is not slowing. Second, the earmarking of the tax for the tribes violates both state and tribal sovereignty. State tax revenues, if derived from a valid tax, would be appropriated to tribal purposes without state legislative approval. And payment of the revenues to the tribe in effect turns the state tax into a tribal tax--all without any action by the legislative arm of the particular tribe. Third, the proposal turns the Department of Justice into a tax administration agency, a role for which it has no expertise. Even the IRS, with all of its expertise and experience, sometimes finds it difficult to administer the tax laws fairly and efficiently. Fourth, this proposal would actually encourage non-compliance by tribes because it would produce tribal revenues that do not otherwise exist. The plan is similar to imposing a penalty for non-compliance of a tax law and then paying over the penalty to the person who is guilty of the non-compliance.

Applied to Members

The tax collection problem involving members, even in the worst cases of non-compliance, is quite minor. States, like all governments, have the power to lay and collect taxes. A state's collection power may stop at the border of the reservation, but it exists every where else outside of Indian Country. If a tribal member's non-compliance behavior is substantial, then substantial sums of money will be involved. This money, when it leaves the reservation, is subject to seizure, as are all other assets of the member located off the reservation. In addition, the member may be guilty of state tax crimes and would be exposed to criminal prosecution upon leaving Indian Country. Admittedly, the residence of a member within Indian Country makes tax collection a greater challenge. Nonetheless, most tax collection techniques if patiently and creatively deployed will ultimately be successful. Once successful, the member will likely go out of business or begin complying.

Tax non-compliance needs to be placed into perspective. IRS estimates its own income tax gap at between 10% to 20%. In the area of income that is not subject to information reporting, the gap is about 80%. States face similar tax compliance problems not involving tribes or their members. In general, states have not come to Congress for assistance. Instead, states have worked together, developed compacts, and attempted to harmonize their tax systems consistence with unique local needs.

I know of no broad-based state support for either of the proposals I have discussed. Foregone tax revenue is a vital issue for states. The silence of the states in this area, however, suggests that states do not view tribes and their members as major tax compliance problems. In fact, it is quite clear that the taxation of Internet

commerce, not tax compliance by tribes, is the front-burner issue for states, as well it should be. The loss of state sales tax revenues because of Internet sales is staggering and is may produce a fiscal crisis for many states.

Examples of Success

A number of states (Minnesota, Wisconsin, Michigan, Arizona, New Mexico, and others) have entered into tax agreements with tribes. Many of these agreements address tax compliance problems and provide adequate remedies. These tax agreements illustrate the benefits that accrue when tribes and states deal with each other on a government-to-government basis. Generally speaking, states, because of greater resources, have the stronger bargaining position when negotiating these agreements with tribes. Tribes, because of their sovereign immunity and their tax immunity in certain cases, do have some strength in their position. Any federal action that would weaken a tribe's bargaining position should be avoided. If anything, Congress should carefully consider how it can strengthen the tax base of tribes and encourage tribal taxation as a means of raising revenues for funding tribal government.

The Navajo Nation just passed its own motor vehicle fuel excise tax. The tax is expected to raise approximately $10 million per year, which will be used for building and maintaining tribal roads and highways. The Navajo Nation, however, has reservation lands in three states: Arizona, New Mexico, and Utah. Each of these three states has its own fuel excise tax system. Arizona negotiated and entered into an inter-governmental tax agreement with the Navajo Nation. The agreement eliminates multiple taxation and provides for revenue sharing based on a statistical study. New Mexico, in contrast, amended its gasoline excise tax and allows tribal stations and member owned stations to deduct any tribal fuel taxes from the New Mexico gasoline excise tax. The effect of this state statute is to eliminate multiple taxation in most cases. Utah, unfortunately, has undertaken no action. As a result, gasoline sold after October 1, 1999, at gas stations in Utah and on the Navajo Nation is subject to both the state and tribal tax. This multiple taxation may make the gasoline the most expensive in the country. Because of this, the Navajo Nation continues diligently in its attempt to encourage Utah to enter into an agreement or to adopt remedial legislation.

Unfair Competition

Obviously different tax rates on the same goods sold within the same market affect the price and provide a competitive price advantage for those goods subject to no or low taxation when compared to high-taxed goods. Differential tax rates from state to state are especially apparent in the northeast where markets cross over state lines. So, Delaware merchants, because they do business in a state with no sales tax, enjoy a competitive advantage over merchants in Maryland, which does have a sales tax. Maryland merchants lose profits and Maryland loses tax revenue. Nonetheless, our federal system allows states to impose or not impose taxes as each sees fit, subject, of course, to commerce clause and due process limitations. We should adopt the same approach with Indian tribes.

When tax cheating is involved (one merchant cheats and the other is honest), the same problem of unfair competition arises. To solve the problem, we allow the tax compliance system to work. In the case of non-compliance by tribes and their members, there is no convincing evidence that state compliance systems have failed. Current remedies are adequate--they are just seldom used.

When tax avoidance is involved (one merchant uses the system to reduce tax and the other does not), the problem of unfair competition remains. But in the case of tax avoidance, the remedy is in the hands of the merchant who does not use tax avoidance. That merchant can remove the competitor's edge by using the

competitor's avoidance device. As already noted, some of the alleged non-compliance in Indian Country is actually avoidance--taxpayers taking advantage of ambiguities in the law. In such instances, allegations of unfair competition are without merit.

Conclusion

Because states currently have adequate means of enforcing those legal taxes imposed within Indian Country and because states do not view compliance as a problem, Congress should not adopt any remedial legislation at this time.

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