

MEMORANDUM

State of Alaska Department of Law

TO: The Honorable Wilson Condon
Commissioner
Department of Revenue

DATE: October 21, 1997

FILE: 663-98-0101

TEL. NO.: 465-3600

SUBJECT: Collection of Tobacco Taxes
from Tribal Smokeshops

FROM: Stephen C. Slotnick
Vincent L. Usera
Assistant Attorneys General
Commercial Section - Juneau

You have requested that we address the question of collection of tobacco taxes on sales of tobacco products by tribal smokeshops located on Indian Country. We conclude that the State can require the smokeshops to collect the tax on sales to customers who are not members of the tribal entity operating the smokeshop. Our analysis follows.

FACTUAL BACKGROUND

Indian smokeshops—shops that sell tobacco products to tribal members free of state taxes—are common on Indian Reservations in the lower 48 states. The authority to make sales to tribal members free from state taxation is an attribute of Indian sovereignty, which exists when the smokeshop is located on “Indian Country,” such as reservation land. Alaska has only one Indian Reservation, the Metlakatla Reserve located on Annette Island. Although the Metlakatla Reserve has an Indian smokeshop, the shop makes few or no sales of tobacco to nontribal members, and Alaska has not previously had to address the issue of taxation of tobacco sales by Indian smokeshops to customers who are not members of the tribe.

Alaska has but one reservation because the Alaska Native Claims Settlement Act revoked all other reserves. The Act provided for the creation of more than 200 state-chartered village and regional corporations, and lands were made available for selection by the corporations without regard to claims of aboriginal use. The land was conveyed to these business corporations in fee.¹

¹ The Ninth Circuit has held that Native corporation land may constitute “Indian Country” which has many of the same attributes of sovereignty as reservations. *Alaska ex rel Yukon Flats School Dist. v. Native Village of Venetie Tribal Gov’t*, 101 F.3d 1286 (9th Cir. 1996). This holding is under

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In 1993, the Klawock Cooperative Association, a federally recognized tribe, opened a smokeshop on the trust land located in Klawock.² The Department of Revenue determined that the Klawock smokeshop was eligible to sell cigarettes tax-free to tribal members.³ At the request of the IRA Council, the department issued an exemption permit to a cigarette distributor, allowing the distributor to wholesale tobacco products to the Klawock smokeshop free from the state tobacco tax.⁴

Between 1993 and October 1997, the department was not concerned about sales of tobacco by the Klawock smokeshop to nontribal members, because the Klawock IRA had assured the department that it intended to sell only to tribal members. On October 1, 1997, however, Alaska's tobacco tax increased from twenty-nine cents to one dollar per pack. Accordingly, the incentive for nonmembers to purchase tobacco products at the Klawock and Metlakatla smokeshops has increased dramatically. Furthermore, the legislature intended the tax to be a disincentive to teen smoking and implementation of that intent requires that the tax not be easily avoidable. Thus, the Department of Revenue has concluded that it must create enforcement mechanisms that will prevent tax-free sales of tobacco products from Indian smokeshops to nonmembers of a tribe.

We understand the department intends to approach the tribes that operate smokeshops and enter into cooperative agreements that would provide for the tribes to collect the state's tobacco taxes on sales to nonmembers. Before beginning any discussions with the tribes, you have asked two questions. First, you have inquired about the "legal incidence" of the tax, based on a concern that a tax that falls on the Indian smokeshop would not be collectible. Second, you have asked whether the state has authority to require an Indian smokeshop to collect a state tax that is imposed on a person who is not a member of the Indian tribe.

DISCUSSION

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review by the United States Supreme Court.

² The IRA Council is the tribal governing body organized under the Indian Reorganization Act of 1934, codified at 25 U.S.C. § 461 *et seq.*

³ In oral advice, the Department of Law affirmed the view that the Klawock cannery site is Indian Country and that sales of tobacco products to tribal members on the site were not subject to state taxation.

⁴ For sales that are not exempt, the wholesaler collects the tobacco tax and remits it to the Department. The exemption certificate allows the wholesaler to sell tobacco products tax-off.

A. Alaska's tobacco tax may be enforced against sales by a tribal smokeshop to nonmembers because the legal incidence of Alaska's tobacco tax falls on the consumer.

Since the very early days of the Union, federally recognized Indian tribes have enjoyed the status of "domestic dependent nations" having many attributes of sovereign control over their own internal affairs on Indian Country. *See Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1 (1831); *Worcester v. Georgia*, 31 U.S. (6 Pet.) 515 (1832). Unless Congress instructs otherwise, "a State's excise tax is unenforceable if its legal incidence falls on a Tribe or its members for sales made within Indian country." *Oklahoma Tax Comm'n v. Chickasaw Nation*, ___ U.S. ___, 115 S.Ct. 2214, 2217 (1995).

It is well-settled law, however, that a state may tax tobacco sales to nonmembers of the Indian tribe that runs the tribal smokeshop. *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505 (1991); *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134 (1980); *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463 (1976). This taxation is allowable because the legal incidence of the tax is on the nonmember, not the member of the Indian tribe. Thus, in order for the State of Alaska to collect its tobacco tax when Indian smokeshops make sales of tobacco products to nonmembers, the legal incidence of the tax must fall on the nonmember.

The State of Alaska imposes a tax on cigarettes imported into the state. "It is the intent and purpose of this section to provide for the collection of this excise from the person who first acquires the cigarettes in this state." AS 43.50.090(b).⁵ "Person" is defined broadly, and every entity from an individual to a political subdivision of the state is included. AS 43.50.170(7). Most Alaska retailers purchase their inventories of cigarettes from distributors who pay the tax to the Department of Revenue.

This scheme does not mean, however, that the legal incidence of the tax is on the smokeshop. Although the tax statutes do not explicitly state that the incidence of the tax is on the consumer, that conclusion follows from the tax scheme and the cases interpreting similar taxes. As the United States Supreme Court has explained:

None of our cases has suggested that an express statement that the tax is to be passed on to the ultimate purchaser is necessary before a State may

⁵ The statutes also impose a tax on tobacco products other than cigarettes. AS 43.50.300. Although the statutes are not identical, the analysis of the legal incidence is the same for both excise taxes.

require a tribe to collect cigarette taxes from non-Indian purchasers and remit the amounts of such tax to the State. Nor do our cases suggest that the only test for whether the legal incidence of such a tax falls on purchasers is whether the taxing statute contains an express “pass on and collect” provision. . . . [In *Colville*,] we accepted [the conclusion] that the statutory scheme required consumers to pay the tax whenever the vendor was untaxable, and thus the legal incidence of the tax fell on purchasers in such cases.

California State Bd. of Equalization v. Chemehuevi Indian Tribe, 474 U.S. 9, 11 (1985). In a later case, the Court noted that the price of cigarettes contains the full amount of the tax at every step in the distribution stream and, therefore, the ultimate bearer of the tax is the consumer, the last person to pay a price for the cigarettes. *Department of Taxation and Finance of New York v. Milhelm Attea & Bros., Inc.*, ___ U.S. ___, 114 S.Ct. 2028, 2031 (1994). Applying the reasoning of these cases to Alaska’s tobacco tax makes clear that the consumer bears the burden of the tax.

Moreover, the plain language of the tax statute establishes that the legislature intended the legal incidence of the tax to fall on the consumer. Alaska Statute 43.50.090(a) provides that the first person acquiring the cigarettes in the state is responsible for *collection* of the tax. Thus, the importer/wholesaler collects the tax, but may pass the tax on to the retailer who, in turn, may pass the tax on to the ultimate consumer.⁶ The legal incidence of the tax, therefore, falls on the consumer. Indeed, the United States Supreme Court has affirmed the State of Washington’s view that the legal incidence of its similar tobacco tax falls on the first constitutionally permissible event that may be taxed. *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 142 n.9 (1980) (“where the wholesaler or the retailer is an Indian on whom the tax cannot be imposed,” the purchase by a non-Indian consumer is the taxable event). Further, under Alaska’s tax scheme, where an unlicensed person offers cigarettes for sale, the person “is considered to have possession of the cigarettes as a consumer and is personally liable for the tax.” AS 43.50.100(d). Thus, the legislature provided that where the first person acquiring the cigarettes in the state does not remit the tax, the consumer, if taxable, will be liable for the tax. This statute affirms legislative intent that the tobacco tax ultimately fall on the consumer, not the smokeshop.

⁶ In a 1993 letter, a Bellingham attorney suggested that AS 43.50.090(b) imposes a tax “directly on the first person who acquires the products in the state” and that “the tax is imposed directly on the tribe, not on the non-Indian purchaser.” Letter from Harry L. Johnsen to Roseann Demert (Oct. 29, 1993). This letter, however, overlooks the cases that explain why the incidence of the tax falls on the consumer, and it fails to recognize that the words “be collected from,” as used in AS 43.50.090(b), are different than the words “is imposed on.”

In sum, the state may not tax a tribal smokeshop, but may tax sales by tribal smokeshops to nonmembers of the tribe. In Alaska, when a tribal smokeshop sells to a nonmember, the legal incidence of Alaska's tobacco taxes, AS 43.50, falls on the consumer, not the smokeshop. Accordingly, Alaska may enforce its tobacco tax laws against sales of tobacco products by tribal smokeshops to nonmembers of the tribe making the sale.

B. The state may require a tribe to collect the state's tobacco tax.

Your second question goes to the practicality of enforcement of tobacco taxes against sales by a tribal smokeshop to nonmembers. The above analysis might suggest that collection and enforcement of the tobacco tax would have to be against the nonmembers who purchase tax-free tobacco products from a tribal smokeshop. Yet, it would not be practicable for the Department of Revenue to collect the tax from a multitude of consumers who purchase tobacco products tax-free from a tribal smokeshop. Accordingly, you ask whether the state may require the tribal smokeshop to collect the tax on sales to nonmembers and then remit the tax to the state.

This question has been addressed many times by the United States Supreme Court. The Court does not analyze the issue as a question of one sovereign attempting to order another to take action. Instead, the Court balances the competing burden on the tribe with the interest of the state, and concludes that the State may require collection of the tax imposed on nonmembers:

The State's requirement that the Indian tribal seller collect a tax validly imposed on non-Indians is a minimal burden designed to avoid the likelihood that in its absence non-Indians purchasing from the tribal seller will avoid payment of a concededly lawful tax. . . . We see nothing in this burden which frustrates tribal self-government . . . or runs afoul of any congressional enactment dealing with the affairs of reservation Indians, . . . [T]o the extent that the "smoke shops" sell to those upon whom the State has validly imposed a sales or excise tax with respect to the article sold, the State may require the Indian proprietor simply to add the tax to the sales price and thereby aid the State's collection and enforcement thereof.

Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation, 425 U.S. 463, 483 (1976). See also *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 155 (1980) ("We do not believe that principles of federal Indian law, whether stated in terms of pre-emption, tribal self-government, or otherwise, authorize Indian tribes thus to market an exemption from state taxation to persons who would normally do their business elsewhere."); *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505, 513 (1991) ("tribal sellers are obliged to collect and remit state taxes on sales to nonmembers at Indian smoke shops on reservation lands").

Indeed, one issue in *Colville* was the rigorous record keeping requirements on cigarette sales imposed on tribal smokeshops by the State of Washington. The Court described the requirements as follows:

The State sales tax scheme requires smokeshop operators to keep detailed records of both taxable and nontaxable transactions. The operator must record the number and dollar volume of taxable sales to nonmembers of the Tribe. With respect to nontaxable sales, the operator must record and retain for state inspection the names of all Indian purchasers, their tribal affiliations, the Indian reservations within which sales are made, and the dollar amount and dates of sales. In addition, unless the Indian purchaser is personally known to the operator he must present a tribal identification card.

447 U.S. at 159. The Court rejected the tribe's claim that these requirements infringed on its sovereignty, and found them to be valid exercises of the state's taxing authority.

A potential problem with a collection requirement is that it may be difficult to enforce against a noncooperative smokeshop.⁷ As an alternative to collection from the smokeshop after the sale has occurred, some states have adopted a rationing scheme where cigarettes for tribal consumption are sold to the tribal smokeshop tax-free, but, based on a formula, the wholesaler collects the state tax for all other cigarettes. In New York, for example, the state adopted regulations which imposed record-keeping requirements and limited the quantities of untaxed cigarettes which could be sold to reservation smokeshops by distributors. One distributor brought suit challenging the regulations on grounds of interference with federal Indian trader statutes. The United States Supreme Court upheld the validity of the rationing scheme:

Moe, *Colville* and *Potawatomi* make clear that the States have a valid interest in ensuring compliance with lawful taxes that might easily be evaded through purchases of tax-exempt cigarettes on reservations; that interest outweighs tribes' modest interest in offering a tax exemption to customers who would ordinarily shop elsewhere. The "balance of state, federal, and tribal interests," *Rice v. Rehner*, 463 U.S. 713, 720, 103 S.Ct. 3291, 3296, 77 L.Ed.2d

⁷ The United States Supreme Court has held that a state has the authority to seize as contraband untaxed cigarettes destined for sale on an Indian Reservation where "the Tribes do not cooperate in collecting the State's taxes." *Colville*, 447 U.S. at 161. The rationing scheme described in the text is designed to avoid the necessity for such enforcement actions.

961 (1983), in this area thus leaves more room for state regulation than in others. In particular, these cases have decided that States may impose on reservation retailers minimal burdens reasonably tailored to the collection of valid taxes from non-Indians.

Department of Taxation and Finance of New York v. Milhelm Attea & Bros., Inc., __ U.S. __, 114 S.Ct. 2028, 2035-36 (1994).

The State of Washington also limits the amount of cigarettes that may be shipped tax-free to reservation Indian retailers. The state uses a combination of tax stamps and “probable demand” calculations to determine the number of tax-free cigarettes that tribes may purchase and police the limitations on shipments. Tax-free shipments to tribes must be pre-approved by the Washington Department of Revenue. This scheme was described and approved by the Ninth Circuit Court of Appeals in *United States v. Baker*, 63 F.3d 1478, 1486 (9th Cir. 1995), the court there making specific reference to *Attea* and explaining its import. 63 F.3d at 1490. You may wish to discuss such a collection scheme when you meet with representatives of the tribal smokeshops.

In sum, the state may require tribes to collect tobacco taxes on sales to nonmembers. The state may also require extensive reporting to ensure that tobacco taxes are being enforced.

We hope this answers your questions. If there is anything further you require in this regard, please do not hesitate to contact us.

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