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State Authority to Tax Out-of-
State Income of Reservation
Indians: A Note on *Fond du Lac*
v. Einess

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SUMMARY

Fond du Lac Band of Lake Superior Chippewa v. Einess presents the question of whether a State can tax the income of Indians living on their own reservation when that income derives from out-of-state sources. On July 29, 2009, the Fond du Lac Band of Lake Superior Chippewa sued the Commissioner of the Minnesota Department of Revenue in federal district court in Minnesota. Brief of Plaintiff-Appellant Fond du Lac Band of Lake Superior Chippewa at 2, *Fond du Lac Band of Lake Superior Chippewa v. Einess*, No. 10-1236 (8th Cir., March 12, 2010) (hereinafter *Band*). Minnesota taxed the pension income of a Mr. Charles M. Diver, a member of the Band. *Id.* For thirty years, Mr. Diver lived in Cleveland and worked for the Yellow Freight Systems company, and now Mr. Diver receives a pension check. Memorandum of Defendant Ward Einess in Opposition to Plaintiff's Motion for Summary Judgment at 4, *Fond du Lac Band of Lake Superior Chippewa*, No. 09-00385 (D. Minn. Oct. 2, 2009) (hereinafter *State*). Mr. Diver now lives on the Band's reservation in northern Minnesota, and his pension checks come from out-of-state. *Id.* at 3. On November 4, 2009, the court denied the Band's motion for summary judgment. *Fond du Lac Band of Lake Superior Chippewa v. Einess*, No. 09-385, slip op. at 8 (Nov. 4, 2009), *available at* <http://turtletalk.wordpress.com> (search "Fond du Lac") (hereinafter *Order*). The Band appealed to the Eighth Circuit. See *Band*.

In this case, the basic legal dispute is over the type of jurisdictional presumption created by the line of Supreme Court Indian tax cases starting with two cases decided on the same day: *Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973) and *McClanahan v. Arizona State Tax Commission*, 411 U.S. 164 (1973). Minnesota argued that *Mescalero*, along with other state tax law cases and concepts, creates a presumption of state jurisdiction to tax any Indian in the state,

which can be overcome only when an Indian matches the key conditions in *McClanahan*: living on a reservation, with income derived solely from activity on the reservation. The Band argued that the same cases, along with other Indian law cases and concepts, creates the presumption that states cannot tax any Indian living on a reservation without express Congressional authorization. Also, the Band argued that taxing the income of an Indian living on the reservation with no other basis than residency within the State undermines tribal sovereignty and violates the Due Process requirements for taxing out-of-state income. The Band may have been surprised that this argument did not prevail, as it was identical to the argument made by another tribe that did prevail under nearly identical facts in federal court in neighboring Wisconsin. See *Lac du Flambeau Band of Chippewa v. Zueske*, 145 F. Supp. 2d 969 (W.D. Wisc. 2000). After analyzing the respective arguments and the underlying law, it seems that Minnesota's position is, ultimately, merely a gloss on federal Indian tax law cases – a gloss that presents a tempting invitation to shape Indian policy by further cabining tribal immunity from State law to only “pure” Indian matters.

MINNESOTA'S ARGUMENT

Minnesota argued that the reservation boundary is a “well-established dividing line” between State jurisdiction and State interference with tribal sovereignty, *State* at 6. Minnesota argued that the Supreme Court's Indian tax law jurisprudence created a scheme in which the only way for an Indian to be immune from the state's plenary taxing jurisdiction is if, like in *McClanahan*, the Indian being taxed lives in Indian Country, and the income being taxed comes from activity inside Indian Country. Otherwise, the income is not on the reservation side of the “dividing line,” and, under *Mescalero*, a State can tax income from off-reservation activity, 411

U.S. 145. In short, unless an Indian can fit within *McClanahan*, the State keeps jurisdiction to tax because Diver lives in Minnesota, *State* at 12.

In *McClanahan*, the Supreme Court denied state tax jurisdiction over an Indian living on the reservation when her income derived entirely from within the reservation. 451 U.S. 164. In later cases, the Court upheld this immunity when an Indian or tribe earned income from an activity within the reservation. *See, e.g.*, *Bryan v. Itasca County*, 426 U.S. 373 (1976), *Moe v. Confederated Salish & Kootenai Tribes of the Flathead Reservation*, 425 U.S. 463 (1976) (Indian sales to Indians on the reservation immune from state taxation). On the other hand, the Court also denied tax immunity when one of the *McClanahan* conditions was lacking. In one line of cases, the Indian or tribe, or the income-earning activity, was located outside of Indian Country. *See, e.g.*, *Mescalero*, 411 U.S. 145 (tribal activity located off-reservation), *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995) (Indian living off of reservation). In another line, the activity, although located inside of Indian Country, nonetheless involved a non-Indian. *See, e.g.*, *Moe*, 425 U.S. 463 (Indian sales to non-Indians on reservation subject to state taxation), *Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95 (2006).

Minnesota argued that the Supreme Court has taught that the conditions of *McClanahan* – an Indian living in Indian Country, earning Indian Country money - are not merely sufficient conditions for immunity, but are actually required conditions. In one Supreme Court case, the Oklahoma Tax Commission, like Minnesota in this case, argued that *McClanahan* required the tribe to prove both “reservation income” and “reservation residence.” *Oklahoma Tax Commission v. Sac and Fox Nation*, 508 U.S. 114, 123 (1993). The Court stated that Oklahoma was only “partially correct,” and that residence in Indian Country that was not within a reservation – there are no reservations in Oklahoma – could be sufficient for federal pre-emption

of state tax jurisdiction. *Id.* The Court then remanded the case with instructions to determine whether the plaintiff resided in Indian Country. *Id.* at 126. Minnesota reasoned that since the Court found Oklahoma to be “partially correct” in its treatment of *McClanahan*, and since the Court corrected Oklahoma only on the residence requirement portion, it follows that the Court found the rest of Oklahoma’s *McClanahan* treatment – i.e. the income requirement – to be fully correct. *State* at 19. In short, Minnesota argued that *McClanahan* requires tribes to prove reservation residence and income because the Court failed to say otherwise when it apparently had the chance.

Under Minnesota’s theory, the Band must prove that Diver’s pension income came from an activity conducted on the reservation. Since Diver’s pension came from his employment in Cleveland, it did not come from an activity conducted on the reservation, and thus cannot meet the *McClanahan* requirement. *State* at 17. The district court accepted Minnesota’s theory. *See Order* at 4.

THE BAND’S ARGUMENT

The Band argued that the Court erred in relying on *Mescalero* for the proposition that States can tax Indians living on a reservation unless they prove otherwise as *Mescalero* did not even address the situation of a state’s ability to tax an Indian living on the reservation; it applied only to a tribe conducting business off of the reservation. *Band* at 4-5. On the other hand, *McClanahan* and the subsequent line of cases show that States have no inherent power to tax Indians on the reservation. *Band* at 6. In one case, Minnesota lacked jurisdiction to tax the mobile home of an Indian living on the reservation because it did not use the process required under a federal law, PL-280, to acquire the jurisdiction of all Indians in the state. *Bryan*, 426 U.S. 373. The Band argued that another case, *California v. Cabazon Band of Mission Indians*,

480 U.S. 202 (1987), teaches that a *McClanahan* analysis requires Congressional authorization to tax any Indian who lives on the reservation. *Band* at 11. The Band further argued that *Sac & Fox Nation* shows that there is a presumption *against* State jurisdiction to tax on-reservation Indians. *Id.*

Since Diver lives on the reservation, and Minnesota could not show express Congressional authorization to tax him, the only connection between the State and Diver's pension income is the fact that Diver lives on a reservation that happens to be within Minnesota. *Band* at 10. However, as in *McClanahan*, this mere presence within the State is not enough for a State to tax an Indian on the Reservation. *Band* at 12. In addition, the Band argued that due process requires a nexus between the State and the out-of-state income being taxed. *Band* at 19-20 (citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940)). Even if residency were nexus enough for a non-Indian, or an Indian living off the reservation, it is not enough for an Indian living on the reservation. *Band* at 23. First, the basis of residency as a nexus that satisfies due process in most cases – the privileges of domicile – is missing in the case of an Indian living on the reservation, because in the latter case, the privileges of domicile flow from the tribe and pre-date the United States and the State of Minnesota. *Band* at 22. In addition, if residency in an in-state reservation were enough to establish a nexus, it would be enough to establish jurisdiction – a result rejected in *McClanahan*. *Band* at 24. Finally, under the Indian canons of construction, the usual tax law principles do not apply to Indians living on the reservation. *Band* at 32.

ANALYSIS

The key to Minnesota's argument is that, under its interpretation of Indian tax law, the Band has to show that Diver's income was from an on-reservation activity. Thus, it does not

really matter where the income comes from, but rather where it does not come from: the reservation. The district court agreed, and found, without analysis, that Diver's income came from an off-reservation source. *Order* at 5. Under the State's formulation of the law, the dispositive finding is "whether Diver's income is characterized as on-reservation activity or off-reservation activity." *Order* at 3.

The weakness in Minnesota's argument is that while the *McClanahan* Court held that Arizona could not tax the income of an Indian living on the reservation when that income was derived entirely from activity on the reservation, it did *not* hold that these sufficient conditions were also necessary conditions. Indeed, the *McClanahan* established a balancing test that weighed the interests of the State against the pre-emptive force of Federal interests, including the Federal interest in tribal sovereignty, 411 U.S. at 172. Minnesota can only show that the necessity of the *McClanahan* "prongs" are implied by the results of other cases, and the negative implication of some language in *Sac and Fox Nation*. But if the *McClanahan* conditions are not the exclusive means to establish immunity from State tax jurisdiction, the State is faced with the much more difficult task of affirmatively establishing its tax jurisdiction.

One weakness in the Band's argument is, according to the district court, that it "has cited no Supreme Court case in which a tribe member has been exempt from a non-discriminatory state tax based on the member's residence on the reservation alone," *Order* at 4. However the Band did not argue that Diver's residence on the reservation, without more, made him exempt; it argued that Diver's residence on the reservation required Minnesota to establish its jurisdiction, which the Band argued it failed to do. Thus, the major weakness in the Band's argument may be that it is technical and relies upon an understanding of basic federal Indian law concepts.

The Eighth Circuit is faced with (at least) these choices. First, it can agree with the policy proposed by the State with its gloss on Indian law to limit Indian tax immunity to on-reservation “value,” *State* at 34. Or, it can agree with the Band and limit the State’s tax jurisdiction of Indians under *Mescalero* to off-reservation and in-State activities only. *Band* at 13. Finally, it can reject the State’s somewhat-bright-line rule about on-reservation value, but find a nexus to out-of-state income that satisfies Due Process without undermining the entire doctrine of tribal sovereign immunity. Given the trend in Indian law cases for courts to grasp opportunities to cabin tribal immunity, the district court’s decision is the unfortunate harbinger.