
U.S. SUPREME COURT UPDATE

U.S. Supreme Court Update

DEBRA S. HERMAN is a partner in the New York City office of the law firm Hodgson Russ LLP.

A New State Tax Preemption Petition as the Court Continues Amid COVID-19 Pandemic

While the U.S. Supreme Court extended certain filing deadlines and postponed certain oral arguments in keeping with the public health precautions recommended in response to the COVID-19 pandemic, the Court did not hit pause!

With respect to state and local tax matters, on February 21, 2020, a new petition for writ of certiorari was filed with the Court in *Noem, South Dakota Governor* v. *Flandreau Santee Sioux Tribe* (Docket No. 19-1056), ruling below at 938 F.3d 928 (8th Cir. 2019). The U.S. Supreme Court has been asked to review a decision of the U.S. Court of Appeals, Eighth Circuit, which held that South Dakota's imposition of a use tax on goods and services sold to non-tribal members of the Flandreau Santee Sioux Tribe (the “Tribe”), a federally recognized tribe, at a casino/hotel and store located on the Flandreau Indian Reservation in Moody County, South Dakota, is preempted by operation of federal law.

We continue to await a decision by the Court in *Espinoza v. Montana Dep't of Rev.* (Docket No. 18-1195), the case that addresses the constitutionality of Montana's Tax Credit Scholarship Program, as well as the Special Master's Report in the MoneyGram cases: *Delaware v. Pennsylvania*, 22O145 and *Arkansas et. al. v. Delaware*, 22O146.

Finally, three previously reported petitions have been denied.

Challenge to Preemption of South Dakota's Use Tax

In *Noem, South Dakota Governor v. Flandreau Santee Sioux Tribe*, (Docket No. 19-1056), ruling below at 938 F.3d 928 (8th Cir. 2019), the U.S. Court of Appeals, Eighth Circuit, affirmed in part and reversed in part the district court's Amended Judgment. The majority of the panel found that the Indian Gaming Regulatory Act ("IGRA," 25 U.S.C. §270125 U.S.C. §2701, *et. seq.*) does not *per se* apply to preempt South Dakota's imposition of a use tax on goods and services sold to non-Tribal members at the Royal River Casino & Hotel (the "Casino") and First American Mart (the "Store") located on the Flandreau Indian Reservation in South Dakota. Rather, as set forth in the majority's opinion, the appellate judges applied a balancing test to determine that the state's interests in imposing the use tax does not outweigh the federal and tribal interests in gaming reflected in IGRA and the history of tribal independence in gaming. Therefore, the imposition of the use tax on non-Tribal member patrons' purchases of goods and services is preempted by federal law.

Background.

The Flandreau Santee Sioux Tribe (the "Tribe") is a federally recognized Indian tribe located in Flandreau, South Dakota. The Tribe owns and operates the Casino and Store on the Flandreau Indian Reservation. As observed by the panel of judges, the "majority of patrons at the Casino and the Store are not members of the Tribe." When the Tribe did not collect the state's use tax on goods and services sold to the nonmember patrons at the Casino and Store, the South Dakota Department of Revenue denied the Tribe's renewals of alcoholic beverage licenses issued to the Casino and the Store, pursuant to S.D. Codified Laws §35-2-24, which provides that "[n]o license under this title may be reissued to an Indian tribe operating in Indian country . . . until the Indian tribe or enrolled tribal member remits to the Department of Revenue all use tax incurred by nonmembers as a result of the operation of the licensed premises." The Tribe appealed the ruling to the South Dakota Office of Hearing Examiners, which upheld the Department's determination.

The Tribe filed an action in the U.S. District Court, District of South Dakota (Southern Division). As explained by the appellate court, the district court “held that IGRA expressly preempts imposing the use tax on nonmember purchases throughout the casino, but does not preempt imposing the tax on nonmember purchases of goods and services at the Store. However, the court concluded, the State may not condition renewal of alcohol beverage licenses on the Tribe's remittance of use taxes imposed on nonmember purchases at the Store.” South Dakota filed an appeal to the U.S. Court of Appeals, Eighth Circuit, asserting that the federal law does not preempt imposition of the state's use tax on nonmember purchases at the Casino of goods and services (which the parties to the litigation refer to as non-gaming “amenities”) and the state may condition renewal of alcohol beverage licenses on the Tribe's failure to remit taxes due the state.

Preemption of state taxation.

The Tribe asserted below that the imposition of the South Dakota use tax on non-Tribal member consumers is preempted under IGRA. Further, to the extent it is not otherwise preempted by IGRA itself, the Tribe argues that the tax is incompatible with federal and tribal interests in protecting tribal self-government and is therefore preempted by federal Indian law in general as it infringes on tribal sovereignty.

The Eighth Circuit discussed the state tax preemption issue by reviewing U.S. Supreme Court precedent. Specifically, the judges observed that “[a]bsent a federal statute permitting it, ‘a State is without power to tax reservation lands and reservation Indians.' *Okla. Tax Comm'n v. Chicksaw Nation*, 515 U.S. 450 , 458 (1995) (quotation omitted). If the legal incidence of a state tax falls on a Tribe or its members for sales made within Indian country, like the state motor fuels excise tax at issue in *Chicksaw Nation*, the tax is categorically unenforceable, without regard to its ‘economic realities.'” With respect to the facts before them, the judges (concurring in the majority opinion 2:1) note that “it is undisputed that the legal incidence of South Dakota's use tax falls on nonmember purchasers of good and services at the Casino and the Store,” thus, they conclude that “[t]he *per se* rule against state taxation of reservation Indians does not apply.” As such, the appellate court determined that it must apply the U.S. Supreme Court's “flexible analysis to determine whether state taxation of nonmembers on Indian land is proper, often called the ‘*Bracker* balancing test,' a reference to the Court's decision in *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980).”

In general, the *Bracker* test requires a “a particularized examination of the relevant state, federal and tribal interests,” together with an examination of “congressional intent,” whereby, “a State seeking to impose a tax on a transaction between a tribe and nonmembers must

point to more than its general interest in raising revenues." In this case, the court found IGRA to be the federal legislation most relevant to the use tax at issue.

IGRA.

In 1988, Congress enacted the Indian Gaming and Regulatory Act ("IGRA"), which was "to provide a statutory basis for the operation of gaming by Indian tribes as a means of promoting tribal economic development, self-sufficiency, and strong tribal governments, and to establish an independent Federal regulatory authority for gaming on Indian lands, [and] Federal standards for gaming on Indian lands." IGRA divides gaming into three classes of increasing regulatory significance. The primary class at issue in this case was Class III games, which includes casino table games and slot machines, and requires, among other items, the existence of a gaming compact between the tribe and the state approved by the Secretary of the Interior. The appellate court explained that IGRA contains no provision authorizing state taxation of Class III gaming, and subsection (d)(4) of 25 U.S.C. §271025 U.S.C. §2710, makes clear that "no such exception was intended: . . . nothing in this section shall be interpreted as conferring upon a State or any of its political subdivisions authority to impose any tax, fee, charge or other assessment upon an Indian tribe or upon any other person or entity authorized by an Indian tribe to engage in a class III activity." The appellate court also found that the Tribe's compact with South Dakota did not address whether the state may impose its use tax on nonmembers for non-gaming activities.

The appellate court explained that "in concluding that IGRA expressly preempts the use tax, the district court reasoned that the prohibition on state taxation in 25 U.S.C. §2710(d)(4)25 U.S.C. §2710(d)(4) 'applies to nonmembers on the Casino floor authorized to gamble, which includes the costs of associated activities, i.e., gamblers and what they spend on gambling, alcohol, food, rooms and other merchandise from the Casino' (the amenities). But subsection (d)(4) is a lack of authorization, not a prohibition." Examining U.S. Supreme Court precedent, notably *Michigan v. Bay Mills Indian Cmty*., 572 U.S. 782 (2014), the court noted that "class III gaming activity" is "what goes on in a casino—each roll of the dice and spin of the wheel." 572 U.S. at 792. Thus, the appellate court concluded that "subsection (d)(4) does not preempt state taxation of nonmember activity, other than 'what goes on in a casino,'" and therefore, the question of federal preemption must be determined under the *Bracker* balancing test.

Bracker test.

As noted above, the *Bracker* balancing test is meant to be a "flexible analysis to determine whether state taxation of nonmembers on Indian land is proper." Per the court, "[s]alient factors include the extent of federal regulation and control, the regulatory and revenue-raising interests of states and tribes, and the provision of state or tribal services." In this regard, "[s] tate jurisdiction is preempted by operation of federal law if it interferes or is incompatible with federal and tribal interests reflected in federal law, unless the state interests at stake are sufficient to justify the assertion of state authority."

The appellate court discussed the history of tribal sovereignty over gaming operations, including the stated purpose of IGRA, which includes "promoting tribal economic development, self-sufficiency, and strong tribal governments . . . ensur[ing] that the Indian tribe is the primary beneficiary of the gaming operation [and] protect[ing] such gaming as a means of generating tribal revenue." 25 U.S.C. §270225 U.S.C. §2702. The court points out that "[e]ven if the amenities at issue are not 'directly related to the operation of gaming activities' . . . , the summary judgment record establishes that the amenities contribute significantly to the economic success of the Tribe's Class III gaming at the Casino." Furthermore, the court noted that the "Tribe submitted evidence that over 90% of its sales tax revenues are generated by the 6% sales tax on transactions at the Casino and the Store," the "Casino departments offering the amenities operate at a loss," and "increases in patronage at one amenity is tied to increases in gaming activity itself." In addition, the Tribe submitted evidence of the Casino's significance in promoting tribal economic development and self-sufficiency.

Based on this evidence, the court found that the "State's taxation of the Casino amenities would raise their cost to nonmember patrons or reduce tribal revenues from those sales" and "[e]ven if gaming was not thereby reduced, the impact would be contrary to IGRA's broad policies of increasing tribal revenues through gaming and ensuring that tribes are the primary beneficiary of their gaming operations to promote economic development, self-sufficiency and strong tribal governments." As such, the court disagreed with the state that any negative impact on the Tribe's finances is insufficient to preempt the tax. In particular, the court concluded "the State's interest in raising revenues to provide government services throughout South Dakota does not outweigh the federal and tribal interests in Class III gaming reflected in IGRA and the history of tribal independence in gaming recognized [by the Supreme Court]" and affirmed the district court's conclusion that the imposition of the South Dakota use tax on non-Tribal member purchases of amenities at the Casino is preempted by federal law.

Liquor licensing.

The district court held that the South Dakota use tax may be imposed on nonmember purchases at the Store, and that the Store can require Tribes to collect and remit the tax. When the Tribe failed to remit the use tax, the State denied the Tribe's renewals of alcoholic beverage licenses issued to the Casino and Store. The district court's Amended Judgment precluded the state from enforcing the non-renewal of the liquor licenses and, thus, the state appealed this issue to the appellate court. The Eighth Circuit framed the issue as "whether the State's remedy for the Tribe's failure to collect and remit valid use taxes—non-renewal of its liquor licenses—is preempted by federal law." The court concluded that the *Bracker* balancing test applies. Specifically, the question is "whether the activity will unduly interfere with Indian trading, or, in this case, with the Tribe's Class III gaming activity." The court said that the Tribe did not address this issue in the district court or on appeal and, thus, "failed to meet its burden to demonstrate that the State alcohol license requirement is not reasonably necessary to further its interest in collecting valid state taxes." As such, the Eighth Circuit reversed the district court's ruling in its Amended Judgment that the State "cannot condition renewal of any alcoholic beverage license issued to the Tribe on the collection and remittance of a use tax on nonmember consumer purchases."

Dissent.

Judge Colloton concurred in part and dissented in part with the court's opinion. While Judge Colloton agreed with the majority that IGRA does not expressly preempt South Dakota's imposition of a use tax on nontribal members' purchases of amenities, he disagreed that federal law preempts the taxation. Judge Colloton primarily relied on the U.S. Supreme Court's decision in *Cotton Petroleum Corp. v. New Mexico,* 490 U.S. 163 (1989) and the fact that the situation here, unlike in the cases relied upon by the majority do not involve a "complete abdication or noninvolvement of the State in the on-reservation activity." Here, Judge Colloton enumerates certain services that the state provides the Casino, including law enforcement operations, roads that facilitate the Casino's 50-mile shuttle service for patrons, job training for Casino employees from the state's Department of Human Services, and inspection of Casino equipment by the state Fire Marshal. In his view, "[a]lthough the state tax revenue derived from the sales of amenities would not equal the cost of the state services provided on the reservation, '[n]either *Bracker*, nor *Ramah* . . . imposes such a proportionality requirement on the States."

Question presented.

Petitioners present the following question to the Court:

This Court prescribed the *Bracker* test to determine whether federal regulation of certain economic activity on Indian reservations preempts state taxation of a non-tribal member's involvement in the regulated activity. Given the conflicting outcomes that have

resulted from the application of the *Bracker* test since its promulgation 40 years ago, and the inception and maturation of a multi-billion-dollar Indian gaming industry since, the question presented is: Does the *Bracker* test currently serve as a consistent and predictable rule of law in light of the exponential expansion of Indian gaming since 1988 and the fiscal demands the industry now places on state budgets?

Petitions Denied

The Court has denied the following previously reported petitions.

The petition in *Wis. Dep't of Revenue v. Union Pac. R.R. Co.* (Docket No. 19-949) was denied on May 4, 2020. In the ruling below, the U.S. Court of Appeals, Seventh Circuit, held that Wisconsin's intangible property tax singles out railroads as part of a targeted and isolated group in violation of the Railroad Revitalization and Regulatory Reform Act of 1976 (the “4-R Act”).

The petition in *Elster v. City of Seattle, Wash.* (Docket No. 19-608) was denied on March 30, 2020. The issue raised was whether Seattle's “Democracy Voucher Program” poses a constitutional problem. This Program, funded by property taxes, provides vouchers to registered municipal voters and qualifying residents, who can, in turn, give the vouchers to a qualified municipal candidate who can then redeem them for campaign purposes.

The petition in *Paz v. Director, Div. of Taxation* (Docket No. 19-921) was denied on March 23, 2020. In the ruling below, the New Jersey Supreme Court found that 100% of the gain from a deemed sale of assets can be taxed in the domiciliary state of a corporation for both corporation business tax purposes and non-resident shareholder gross income tax purposes.

END OF DOCUMENT -