

## Elevating Form over Substance at the Expense of Indian Sovereignty [ *Wagnon v. Prairie Band Potawatomi Nation*, 126 S. Ct. 676 (2005) ]

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*An unlimited power to tax involves, necessarily, a power to destroy.*<sup>1</sup>

### I. INTRODUCTION

When the Europeans “discovered” America in 1492, five million people in 600 Indian tribes already inhabited the area now known as the United States.<sup>2</sup> Each tribe had its own language and government and considered itself a distinct sovereign entity.<sup>3</sup> Sovereignty is the force or power that ties a community together where the community possesses the rights to structure a government, establish its own laws, and regulate foreign relations and trade.<sup>4</sup> These sovereign communities were essential to the survival of the European settlers early on.<sup>5</sup> Fights erupted, however, as the settlers invaded Indian territory to acquire additional land.<sup>6</sup>

As the fighting between the Indians and the settlers was becoming increasingly violent, the Revolutionary War erupted between the settlers and the British.<sup>7</sup> Because the settlers invaded Indian territory, they feared that the Indians would support the British in the war.<sup>8</sup> Therefore, the settlers developed a strategy to discourage Indian support of the British by fighting the war in Indian Country, which resulted in destroyed villages, burned crops, destruction of Indian homes, and loss of

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1. *McCulloch v. Maryland*, 17 U.S. 316, 327 (1819).

2. SHARON O'BRIEN, *AMERICAN INDIAN TRIBAL GOVERNMENTS* 14 (1989). One commentator suggests that it is fair to ask if the Indians would be credited with discovering Europe if they had sailed a ship there in 1492. STEPHEN L. PEVAR, *THE RIGHTS OF INDIANS AND TRIBES* 4 (3d ed. 2002) (1983).

3. O'BRIEN, *supra* note 2, at 14.

4. *Id.*

5. PEVAR, *supra* note 2, at 5.

6. *Id.*

7. *Id.*

8. *Id.*

Indian lives.<sup>9</sup>

After the war, Indians accepted government-imposed limitations on their sovereignty in exchange for treaty agreements between the Indians and the United States.<sup>10</sup> These treaties, and the subsequent Supreme Court decisions interpreting them, protected Indian sovereignty as inherent to tribal government.<sup>11</sup> Nevertheless, the tumultuous relationship between Indians and the United States government has continued into modern times, with disagreements arising between states and Indians over sovereignty—specifically over issues of casino building, the environment, civil rights, and domestic relations.<sup>12</sup> Congress addresses these conflicts through legislation,<sup>13</sup> yet remains silent in the most controversial area of conflict between states and Indians: state-imposed taxes within Indian Country.<sup>14</sup>

This comment examines the recent Supreme Court decision *Wagon v. Prairie Band Potawatomi Nation*.<sup>15</sup> The comment analyzes whether the “legal incidence of the tax” is the appropriate test to apply in Indian tax immunity cases when Indian tribal sovereignty issues are involved. Finally, it explores the alternative to “legal incidence of tax” by examining the “economic incidence of tax” through the common law doctrine of substance over form.

## II. CASE DESCRIPTION

The Prairie Band Potawatomi Nation (Nation) is a federally recognized Indian tribe that operates a casino on its reservation in Kansas.<sup>16</sup> The Nation also operates a gas station, Nation Station, near the casino.<sup>17</sup> An off-reservation distributor brings gas and diesel fuel onto the reservation to be resold at Nation Station.<sup>18</sup> The Nation sold this fuel at fair market prices (within \$0.02 on average) and did not market an exemption from state fuel taxes.<sup>19</sup> The Nation imposed a tribal tax on each

9. *Id.* at 4 (quoting COLIN G. CALLOWAY, *THE AMERICAN REVOLUTION IN INDIAN COUNTRY* 47, 65 (1995)). Indian Country is defined as “all land within the limits of any Indian reservation under the jurisdiction of the United States Government, notwithstanding the issuance of any patent, and, including rights-of-way running through the reservation.” 18 U.S.C. § 1151 (1994).

10. Eileen M. Luna, *The Impact of the Unfunded Mandates Reform Act of 1995 on Tribal Governments*, 22 AM. INDIAN L. REV. 445, 454 (1998).

11. *Id.*; see *Cherokee Nation v. Georgia*, 30 U.S. 1, 60 (1831); *Worcester v. Georgia*, 31 U.S. 515, 580-81 (1832).

12. Luna, *supra* note 10, at 459-62, 464, 466-67.

13. Jennifer Nutt Carleton, *State Income Taxation of Nonmember Indians in Indian Country*, 27 AM. INDIAN L. REV. 253, 253 n.2 (2003); see also, e.g., Indian Gaming Regulatory Act, Pub. L. No. 100-497, 102 Stat. 2467 (1988) (codified as amended at 18 U.S.C. §§ 1166-68 (1994); 25 U.S.C. §§ 2701-21 (1994)); Indian Child Welfare Act, 25 U.S.C. §§ 1901-63 (1994).

14. Carleton, *supra* note 13, at 253 (noting that Congress has not passed legislation addressing the state’s ability “to tax individuals, activities, or income within Indian Country”).

15. 126 S. Ct. 676 (2005).

16. *Prairie Band Potawatomi Nation v. Richards*, 241 F. Supp. 2d 1295, 1297 (D. Kan. 2003).

17. *Id.*

18. *Id.*

19. *Prairie Band Potawatomi Nation v. Richards*, 379 F.3d 979, 982 (10th Cir. 2004), *rev’d sub*

gallon of gasoline and diesel fuel sold of \$0.16 and \$0.18 respectively, which accounted for \$300,000 in tribal fuel revenue each year.<sup>20</sup> It used the revenue to construct and maintain roads on and near the reservation.<sup>21</sup>

Before May of 1995, Kansas did not impose a fuel tax when distributors delivered fuel to Indian reservations.<sup>22</sup> The Kansas Legislature, however, amended the Kansas motor-fuel tax law in 1995 and began to impose tax on fuel that distributors delivered to Indian reservations.<sup>23</sup> The amended statute places “the legal incidence of the tax on fuel distributors, but permits the distributors to pass the tax directly to the fuel retailers” (i.e., Nation Station).<sup>24</sup> The Nation sued and sought injunctive and declaratory relief to prohibit Kansas from imposing the motor fuel tax on fuel delivered on-reservation.<sup>25</sup>

#### A. *United States District Court, District of Kansas*

In United States District Court for the District of Kansas, the Nation claimed that the Kansas statute was invalid because it was preempted under the Indian Commerce Clause<sup>26</sup> and the Nation’s sovereignty and self-government rights.<sup>27</sup> The Nation argued that preemption barred Kansas from imposing tax on the fuel delivered on-reservation.<sup>28</sup> The district court recognized that “a state tax is unen-

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*nom.* Wagon v. Prairie Band Potawatomi Nation, 126 S. Ct. 676 (2005).

20. *Potawatomi Nation*, 241 F. Supp. 2d at 1298.

21. *Id.*

22. *Id.*

23. *Id.*; see also KAN. STAT. ANN. § 79-3401 to -3409 (1997).

24. *Potawatomi Nation*, 241 F. Supp. 2d at 1298. “Every distributor paying such tax or being liable for the payment shall be entitled to charge and collect an amount, including the cost of doing business that could include such tax on motor-vehicle fuels . . . sold or delivered by such distributor, as a part of the selling price.” KAN. STAT. ANN. § 79-3409 (Supp. 2005).

25. *Potawatomi Nation*, 241 F. Supp. 2d at 1299.

26. The district court chose to dispose of the case on other grounds without addressing the Indian Commerce Clause, other than to discuss federal preemption. *Id.* at 1307. The court never discussed the burden on commerce. When the Commerce Clause is in reference to Indians, courts and commentators refer to it as the “Indian Commerce Clause.”

27. *Id.* at 1299. Kansas argued that summary judgment was appropriate for the following reasons: (1) the state was entitled to Eleventh Amendment immunity, (2) the Nation lacked standing, and (3) “the Hayden-Cartwright Act provide[d] congressional consent for imposition of the State’s fuel tax.” *Id.*; see U.S. CONST. amend. XI; 4 U.S.C. § 104 (1994). The court dismissed the state’s argument that the Eleventh Amendment barred the suit. *Potawatomi Nation*, 241 F. Supp. 2d at 1301. The court indicated that the Supreme Court, in *Ex parte Young*, 209 U.S. 123 (1908), “created a legal fiction, circumventing Eleventh Amendment immunity” and allowed suits seeking injunctive and declaratory relief when plaintiffs sue state officials in their official capacity. *Potawatomi Nation*, 241 F. Supp. 2d at 1299-1300. The court also held that the Nation had standing to sue the state for injunctive and declaratory relief for the following reasons: (1) the Nation claimed “interference with the right of self-government and economic injury caused by the state fuel tax,” (2) “the alleged injury is directly traceable to the State’s desire to impose [the tax], in that the Act allows the tax to be passed on directly to the retailers,” and (3) “deciding in favor of the [Nation] will redress the alleged injury . . .” *Id.* at 1303. These issues are generally beyond the scope of this comment and will not be discussed further.

28. *Potawatomi Nation*, 241 F. Supp. 2d at 1307.

forceable if the legal incidence of the tax falls on an Indian tribe . . . ,”<sup>29</sup> and adopted the analysis of the United States Court of Appeals for the Ninth Circuit in *Salt River Pima-Maricopa Indian Community v. Arizona*.<sup>30</sup> That court indicated that the dispositive factors in determining that state law was not preempted by federal law in Indian tax immunity cases are: “[ (1) ] the goods or services taxed were non-Indian, [ (2) ] the legal incidence of the tax falls on non-Indians, and [ (3) ] the state provided most of the governmental services to those that bear the economic burden of the state tax.”<sup>31</sup> In this case, the district court held that the legal incidence of the Kansas motor-fuel tax law undisputedly rested on non-Indians, the motor fuel was a non-Indian product, and the consumer, as the ultimate economic bearer of the tax, received the governmental services provided by Kansas.<sup>32</sup> Therefore, federal law did not preempt the state.

The Nation’s second argument was that the motor fuel tax infringed on the rights of the Nation to self-govern and to impose its own fuel tax.<sup>33</sup> The basis of the analysis required the court to weigh both the interests of the state and the Nation in raising revenue for governmental services.<sup>34</sup> The Nation’s interest in raising revenues for governmental “services is strongest when ‘the revenues are derived from value generated on the reservation by activities involving the Tribes and when the taxpayer is the recipient of tribal services.’”<sup>35</sup> If the Nation could demonstrate that it shouldered the ultimate economic burden, then the state tax interfered with tribal self-government.<sup>36</sup> The Nation’s evidence, however, indicated that Nation Station sold only a small percentage of fuel to tribal members, and thus, the main recipients of state governmental services were not tribe members.<sup>37</sup> The court held that the tax did not interfere with tribal affairs, and, therefore, granted summary judgment in favor of Kansas.<sup>38</sup>

### *B. United States Court of Appeals for the Tenth Circuit*

The Nation appealed the district court’s summary judgment decision.<sup>39</sup> At the United States Court of Appeals for the Tenth Circuit, the

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29. *Id.*

30. 50 F.3d 734 (9th Cir. 1995); see also *Potawatomi Nation*, 241 F. Supp. 2d at 1308-09.

31. *Potawatomi Nation*, 241 F. Supp. 2d at 1308-09.

32. *Id.* at 1309.

33. *Id.*

34. *Id.*

35. *Id.* at 1309-10 (quoting *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134, 156-57 (1980)) (emphasis omitted).

36. *Id.* at 1310.

37. *Id.* at 1310-11.

38. *Id.*

39. *Prairie Band Potawatomi Nation v. Richards*, 379 F.3d 979, 981 (10th Cir. 2004), *rev’d sub nom.* *Wagnon v. Prairie Band Potawatomi Nation*, 126 S. Ct. 676 (2005).

Nation put forth two arguments for reversal of the decision: (1) federal law preempts the state tax because when interests are balanced, federal and tribal interests against the tax outweigh Kansas's interest to levy the tax, and (2) the fuel tax infringes on tribal sovereignty and is therefore invalid.<sup>40</sup> The Tenth Circuit reviewed each argument and reversed the decision.

Under preemption challenges involving Indians, courts consider the differences between tribal sovereignty and state sovereignty.<sup>41</sup> The Tenth Circuit recognized the balancing of interests and indicated that federal law preempts state law if it interferes with federal and tribal interests, unless the state's interests are sufficiently justified.<sup>42</sup> The appropriate question to ask when tribes challenge state taxes is "who bears the legal incidence of [the] tax?"<sup>43</sup> If the legal incidence of a state tax falls on the Indian tribe for sales made on the reservation, the state cannot enforce the tax.<sup>44</sup> Because the legal incidence of Kansas's motor-fuel tax law statutorily fell on non-Indians, Kansas could enforce the tax if both the balance of federal, state, and tribal interest tilted toward the state, and "federal law [was] not to the contrary."<sup>45</sup>

Using the *White Mountain Apache Tribe v. Bracker*<sup>46</sup> interest-balancing test, the court balanced the competing interests and held that tribal and federal interests outweighed Kansas's interest in the tax.<sup>47</sup> Raising revenue to maintain the tribal government was an interest of the Nation,<sup>48</sup> which was strongest when the tribe generated the revenue from value created on the reservation, "and when the taxpayer was the recipient of tribal services."<sup>49</sup> The Nation generated its fuel tax revenues from value created on the reservation.<sup>50</sup> This value existed because the Nation created a new fuel market by building a casino, not because the Indians advertised an exemption to state taxation.<sup>51</sup> The court also noted the federal interest—promoting economic development and Indian self-sufficiency.<sup>52</sup> Balancing the Nation's interests and the fed-

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40. *Id.* at 982-83.

41. *Id.* at 983.

42. *Id.*

43. *Id.* (quoting *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 458 (1995)).

44. *Id.*

45. *Id.*

46. 448 U.S. 136 (1980); see *infra* text accompanying notes 119-129.

47. *Potawatomi Nation*, 379 F.3d at 983-84.

48. *Id.*

49. *Id.* (quoting *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 156-57 (1980)).

50. *Id.* at 984.

51. *Id.*

52. *Id.* at 986. The court stated that these goals are found "in numerous Acts of Congress, Executive Branch policies, and judicial opinions." *Id.* See generally Indian Gaming Regulatory Act, 25 U.S.C. §§ 2701-21 (1994); Indian Reorganization Act of 1934, 25 U.S.C. §§ 461-79 (1994); Indian Self-Determination and Education Assistance Act of 1975, 25 U.S.C. § 450f (1994). See also Presidential Proclamation 7500 of Nov. 12, 2001, 66 Fed. Reg. 57641 (Nov. 15, 2001).

eral interests against Kansas's legitimate governmental interest in raising revenue, the Tenth Circuit determined that Kansas's interest was strongest when the state directs its tax to off-reservation activities.<sup>53</sup> Kansas's interest, therefore, was not the strongest when, as in this case, the state directs its tax at tribal revenue derived from value created on the reservation.<sup>54</sup> The court ultimately held that Kansas's generalized interest in raising revenue was insufficient to justify the motor fuel tax, and the tax was therefore invalid.<sup>55</sup>

### III. BACKGROUND

Taxation conflicts have existed between states and Indians since the ratification of the Constitution. One particular reason for the continuous conflict is the unique sovereignty implications.<sup>56</sup> In *McCulloch v. Maryland*,<sup>57</sup> the Supreme Court recognized that the freedom of one sovereign from taxation by another sovereign is a fundamental aspect of the United States federal system.<sup>58</sup> Conflicts arise today, however, because courts have adopted a more flexible rule in Indian tax immunity cases; states may tax Indian activities unless a federal law or treaty preempts the tax, or if the tax imposes on the rights of Indians to make their own laws.<sup>59</sup> The most recent conflict between Kansas and Indian nations began in 1995 and culminated with the Supreme Court decision in *Potawatomi Nation*. An examination of Indian sovereignty and the United States policy toward it is necessary to understand the tax controversy in *Potawatomi Nation*.

#### A. Indian Sovereignty

The key to adjudicating an Indian tax immunity case is to analyze the status of Indian tribes.<sup>60</sup> Historically, Indian tribes have been considered sovereign nations similar to states, dependent nations, and wards of the federal government.<sup>61</sup> If the Indian tribes are sovereign, a determination of the extent to which one sovereign can tax another sovereign is necessary.

Congress's and the President's understanding of whether Indian tribes are sovereign—whether as states, dependent sovereign nations, or

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53. *Potawatomi Nation*, 379 F.3d at 986-87.

54. *Id.* at 987.

55. *Id.*

56. A complete analysis of tax conflicts is beyond the scope of this comment.

57. 17 U.S. 316 (1819).

58. *Id.* at 432.

59. AMERICAN INDIAN LAW DESKBOOK 313 (Julie Wrend et al. eds., 2d ed. 1998) (citing *Rice v. Rehner*, 463 U.S. 713 (1983)).

60. See Ann McCulloch, *Indian Tribal Taxation: A Cornerstone of Sovereignty*, in NATIVE AMERICAN SOVEREIGNTY 179, 181 (John R. Wunder ed., Garland Publ'g 1999) (1996).

61. *Id.*

simply sovereign nations—is critical in modern jurisprudence.<sup>62</sup> President George W. Bush’s comments on Indian tribal sovereignty, however, are evidence of the federal government’s lack of understanding of tribal sovereignty. When asked “[w]hat do you think tribal sovereignty means in the 21st century and how do we resolve conflicts between tribes and the federal and state governments,” President Bush responded, “[t]ribal sovereignty means that, it’s sovereign. You’re a—you’re a—you have been given sovereignty and you’re viewed as a sovereign entity . . . . And therefore, the relationship between the federal government and tribes is one between sovereign entities.”<sup>63</sup> Although the President’s answer to a question should not, and generally does not, create Indian policy, it demonstrates that Indian sovereignty is key to setting such policy. Without direction from Congress or the President, the Supreme Court has latitude to set federal Indian policy, which it did when it decided *Potawatomi Nation*.

Sovereignty is a “supreme power” which binds a people and a nation together and empowers them to self-govern.<sup>64</sup> It is an inherent power that cannot change over time;<sup>65</sup> only its manifestations as nations, governments, or politics change.<sup>66</sup> Indians were exercising this power before European settlers arrived in North America.<sup>67</sup> Most of the Indian tribes organized themselves as democratic governments and recognized the sovereignty of “one another by forming compacts, treaties, trade agreements, and military alliances” with each other.<sup>68</sup> Although they considered themselves sovereign, the new government of the United States took a different view.

The American Heritage Dictionary defines “nation” as “[a] federation or tribe, especially one composed of North American Indians” or “[t]he territory occupied by such a federation or tribe.”<sup>69</sup> The Supreme Court has repeatedly recognized Indian tribes as sovereign nations.<sup>70</sup> In *Cherokee Nation v. Georgia*,<sup>71</sup> the Court held that Indian tribes were domestic dependent nations capable of managing their own affairs and

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62. See Robert Laurence, *The Indian Commerce Clause*, 23 ARIZ. L. REV. 203, 223 (1981).

63. Interview by Mark Trahan with President George W. Bush, in Washington D.C. (Aug. 6, 2004), available at <http://www.democracynow.org/article.pl?sid=04/08/10/149259> (Mark Trahan is Editor for the Seattle Post-Intelligencer and a member of Idaho’s Shoshone-Bannock Tribe and former president of the Native American Journalists Association.).

64. Kirke Kickingbird et al., *Indian Sovereignty*, in NATIVE AMERICAN SOVEREIGNTY 1, 4 (John R. Wunder ed., Garland Publ’g 1999) (1996).

65. *Id.*

66. *Id.*

67. *Id.* at 5.

68. *Id.* at 6.

69. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 874 (High-Sch. ed. 1982).

70. See *Montoya v. United States*, 180 U.S. 261, 265 (1901); *Marks v. United States*, 161 U.S. 297, 302-04 (1896); *Worcester v. Georgia*, 31 U.S. 515, 561 (1832).

71. 30 U.S. 1 (1831).

governing themselves.<sup>72</sup> Chief Justice John Marshall elaborated further on Indian nation status in *Worcester v. Georgia*,<sup>73</sup> where he stated that “Indian nations had always been considered as distinct, independent political communities, retaining their original natural rights, as the undisputed possessors of the soil, from time immemorial . . . .”<sup>74</sup> The Court further noted that it is settled in the law of nations that a weaker nation does not surrender its sovereignty by associating with a stronger sovereign nation.<sup>75</sup>

Throughout the tumultuous history between the United States and the Indians, the government and the courts have eroded Marshall’s theory. For example, the Supreme Court in the late nineteenth and early twentieth century referred to Indians as “‘wards’ of the government.”<sup>76</sup> In 1871, Congress “announced that it had plenary power over” the Indians, which subjected Indians to the “whims of Congress.”<sup>77</sup> In 1959, the Supreme Court began a transition back to Marshall’s theory of Indian sovereignty when it held that internal Indian affairs remain with the tribal government and states could not interfere.<sup>78</sup> Then, in *United States v. Wheeler*,<sup>79</sup> the Court reaffirmed its commitment to Indian sovereignty by holding that Indian tribes continue to possess their original sovereignty.<sup>80</sup> Thus, courts now consider Indian tribes as sovereign nations. Considering that Indian tribes are physically located within state boundaries, however, the extent of tribal sovereignty and the state’s role in that sovereignty are and have been a source of conflict.

### B. U.S. Policy Toward Indians – Historical Perspective

The conflicts over sovereignty between the states and Indians commenced following the Revolutionary War.<sup>81</sup> After the war, Indian tribes were strong militarily, were a threat to the United States, and were concerned with their own sovereignty.<sup>82</sup> Thus, to avoid military altercations, the United States adopted the official position that Indian tribes were equal to foreign nations and attempted to maintain a good relationship with them.<sup>83</sup> Although Indian reservations were now located within the new United States, Congress refrained from passing

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72. *Id.* at 17.

73. 31 U.S. 515 (1832).

74. *Worcester*, 31 U.S. at 559; see also McCulloch, *supra* note 60, at 182 (quoting *Worcester*, 31 U.S. at 559).

75. *Worcester*, 31 U.S. at 560-61.

76. McCulloch, *supra* note 60, at 182.

77. *Id.*

78. See, e.g., *Williams v. Lee*, 358 U.S. 217, 218, 223 (1959).

79. 435 U.S. 313 (1978).

80. *Id.* at 323.

81. See O'BRIEN, *supra* note 2, at 49-50.

82. PEVAR, *supra* note 2, at 6.

83. *Id.*

laws that would limit Indian sovereignty.<sup>84</sup> Instead, it continued to respect the rights of Indians to govern themselves, at least until the election of Andrew Jackson in 1828.<sup>85</sup>

President Jackson's policy toward Indians "became a publicly stated goal: removal of the eastern Indian tribes to the West."<sup>86</sup> Because of the rapid increase in population and the strength of the United States military, the United States no longer needed to avoid conflict with the Indians; instead, it needed land for white settlements.<sup>87</sup> Thus, in 1830, Congress passed the Indian Removal Act, which authorized the President to relocate eastern Indian tribes to the west.<sup>88</sup> Jackson's policy became "the dominant federal Indian policy of the nineteenth century."<sup>89</sup> Further, Congress passed laws to gain additional control over the tribes,<sup>90</sup> such as a law passed in 1871, which prohibited the federal government from entering into treaties with Indians and in effect meant that Congress no longer considered tribes as equal to foreign nations.<sup>91</sup>

Between 1887 and 1934, the desire to appropriate more Indian land dominated United States policy toward Indians.<sup>92</sup> In 1887, Congress passed the General Allotment Act (GAA),<sup>93</sup> which was designed to "extinguish tribal sovereignty, erase reservation boundaries, and force the assimilation of Indians into the society at large."<sup>94</sup> The GAA authorized the President, through the Secretary of the Interior, to assign an allotment of tribally held lands to Indian tribes; the government then sold the "surplus" land to non-Indians.<sup>95</sup> When Congress repealed the GAA in 1934, Indians owned fifty million acres of land, considerably less than the 150 million acres of land they owned before the GAA.<sup>96</sup>

In the 1930s, federal Indian policy changed to a more humane approach because of the Merriam Report, an influential study that detailed the "severe and hopeless conditions faced by Indians" resulting from United States Indian policies.<sup>97</sup> President Franklin Roosevelt chose to restore tribal independence and appointed John Collier as

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84. *Id.* Laws such as the Northwest Ordinance of 1787 were passed declaring, "[t]he utmost good faith shall always be observed towards Indians; their land and property shall never be taken from them without their consent." *Id.* The law was never really enforced. *Id.*

85. *Id.* at 7.

86. *Id.*

87. *Id.*

88. *Id.* As a result of a "forced march to the Oklahoma Indian Territory," which became known as the "Trail of Tears," 15,000 Indians died. *Id.*

89. *Id.* (quoting VINE DELORIA JR., *AMERICAN INDIAN POLICY IN THE TWENTIETH CENTURY* 242 (1985)).

90. *Id.* at 8.

91. *Id.* (citing 16 Stat. 544, 566 (codified at 25 U.S.C. § 71)).

92. *Id.*

93. 25 U.S.C. § 71 (1994). The General Allotment Act is also known as the Dawes Act.

94. PEVAR, *supra* note 2, at 8.

95. *Id.* at 8-9.

96. *Id.* at 9.

97. *Id.* Indians faced extreme poverty, inadequate food, and lacked basic human necessities. *Id.*

Commissioner of Indian Affairs, who declared in 1934 that “[n]o interference with Indian religious life or expression will hereafter be tolerated.”<sup>98</sup> From the mid-1930s until today, United States Indian policy has been inconsistent because some acts have recognized Indian sovereignty, while others have stripped it.<sup>99</sup> In 1953, Indians suffered because of the Eisenhower Administration’s termination policy, which brought Indian tribes near total disaster.<sup>100</sup> Termination was the policy that ended United States’ control of Indian land through its trust relationship with tribes.<sup>101</sup> As a result, tribes lost federal benefits and support, faced governmental destruction, and ultimately lost control of the lands to the states.<sup>102</sup> Because of the termination policy, Congress eliminated 109 tribal reservations and gave full jurisdiction over the land to the states.<sup>103</sup>

In the late 1960s, the federal government changed its policy toward Indians once again. President Johnson proclaimed, “We must affirm the rights of the first Americans to remain Indians while exercising their rights as Americans. We must affirm their rights to freedom of choice and self-determination.”<sup>104</sup> The Johnson Administration viewed termination as destructive and inhumane, and thus repudiated the policy.<sup>105</sup> President Richard Nixon also denounced the termination policy in 1970, stating, “This, then, must be the goal of any new national policy toward the Indian people: to strengthen the Indian sense of autonomy without threatening his sense of community.”<sup>106</sup> President Ronald Regan also endorsed tribal sovereignty, stating, “This administration intends to restore tribal governments to their rightful place among governments of this nation and to enable tribal governments, along with State and local governments, to resume control over their own affairs.”<sup>107</sup>

Thus, since the 1960s, the federal government has generally promoted Indian sovereignty.<sup>108</sup> The government has recognized that sovereign nations have many powers necessary for self-government, including: (1) “[t]he power to make and enforce laws,” (2) “[t]he power to regulate [the land],” (3) “[t]he power to determine membership,” (4)

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98. *Id.* at 10.

99. *See id.* In June 1934, Congress passed the Indian Reorganization Act, which “sought to rejuvenate tribal government.” *Id.* The act protected tribal lands, prohibited further allotment, authorized the Secretary of the Interior to add land and create new reservations, encouraged Indians to adopt their own constitutions, and established a twenty million dollar revolving credit fund from which the government could loan money to tribes. *Id.*

100. *Id.* at 11.

101. *Id.*

102. *Id.*

103. *Id.* The states were elated with this outcome. *See id.* Because states could not control Indian affairs, states resented Indian reservations within the state boundaries. *Id.*

104. *Id.* at 12.

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

“[t]he power to regulate trade,” and (5) “[t]he power to impose and collect taxes.”<sup>109</sup> Using these criteria as a basis, legislation since the mid 1970s indicated that Indian tribes are sovereign. In 1994, President Bill Clinton renewed the United States government’s position of recognizing Indian sovereignty by issuing an executive order that required all federal agencies to transact business affairs “with tribes on a ‘government-to-government’ basis.”<sup>110</sup> Given the radical changes in United States policies toward Indians throughout history, the future of the relationship is unpredictable.<sup>111</sup> “Today’s era of self-determination can become tomorrow’s era of termination,” and only time will tell whether the President and Congress will support tribal sovereignty.<sup>112</sup>

### C. Motor Fuel Tax Conflicts Leading to Potawatomi Nation

One of the most controversial issues of Indian sovereignty has been the taxation of tribes. Before 1995, Kansas and the Nation had an inter-governmental compact whereby Kansas agreed that if the Nation was imposing its own tribal tax, then Kansas would not impose a tax.<sup>113</sup> One commentator has indicated that more than 200 Indian tribes across the United States have resolved their taxation disputes by entering into such compacts.<sup>114</sup> Kansas, however, refused to renew the compact with the Nation in 1995,<sup>115</sup> following the Supreme Court’s decision in *Oklahoma Tax Commission v. Chickasaw Nation*.<sup>116</sup> In *Chickasaw Nation*, the Court held that states could impose tax on Indian tribes if the legal incidence of the tax was on a non-Indian.<sup>117</sup> The precursor to the *Chickasaw Nation* decision was the 1980 Supreme Court case of *White Mountain Apache Tribe v. Bracker*.<sup>118</sup>

In *Bracker*, the Court considered the extent to which Arizona had authority over non-Indians engaged in transactions with Indians on Indian reservations.<sup>119</sup> Arizona sought to impose its motor carrier and fuel tax on non-Indians who worked solely on-reservation.<sup>120</sup> The tribe argued that federal law preempted the taxes, and the Court agreed.<sup>121</sup>

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109. Kickingbird et al., *supra* note 64, at 1, 5.

110. See PEVAR, *supra* note 2, at 13.

111. *Id.*

112. *Id.*

113. See Joint Appendix at 20-26, *Wagon v. Prairie Band Potawatomi Nation*, 126 S. Ct. 676 (2005) (No. 04-631).

114. Richard J. Anns, Jr., *State Taxation of Non-Indians Whom Do Business with Indian Tribes: Why Several Recent Ninth Circuit Holdings Reemphasize the Need for Indian Tribes to Enter into Taxation Compacts with Their Respective State*, 78 OR. L. REV. 501, 546 (1999).

115. See *Kaul v. Lafaver*, 790 P.2d 60 (Kan. 1998).

116. 515 U.S. 450 (1995).

117. See *id.* at 458-59.

118. 448 U.S. 136 (1980).

119. *Id.* at 137.

120. *Id.* at 137-38.

121. See *id.* at 138.

In its reasoning, the Court recognized that Congress retains broad power to regulate affairs with Indians under the Commerce Clause.<sup>122</sup> Two barriers exist, however, that prevent the exercise of state authority over Indians: (1) federal law may preempt state authority, and (2) state law may not “infringe ‘on the right of reservation Indians to make their own laws and be ruled by them.’”<sup>123</sup> Evaluating these barriers against the state imposed taxes, the Court differentiated between transactions involving only Indians, and transactions involving non-Indians with Indians on-reservation.<sup>124</sup> When transactions occur on-reservation and involve only Indians, courts impose a categorical rule: states generally cannot impose their laws, including state taxes, upon the transaction.<sup>125</sup> Alternatively, when the state asserts authority over on-reservation activity between non-Indians and Indians, the Court uses a balancing test to determine if a state can impose a tax.<sup>126</sup> The balancing test weighs the interests of the state, the federal government, and the tribe to determine if federal law preempts state law.<sup>127</sup> In *Bracker*, the Court weighed the interests and determined that federal law preempted the state tax.<sup>128</sup> Since 1980, the Court has repeatedly applied the *Bracker* interest-balancing test to determine if federal law preempts state taxes on non-Indians for various on-reservation transactions.<sup>129</sup> The Court further explained the categorical and interest balancing approaches in *Chickasaw Nation*, a case with similar facts to *Potawatomi Nation*.

In *Chickasaw Nation*, Oklahoma imposed a motor fuel tax on fuel sold by the Chickasaw Nation on its Indian reservation.<sup>130</sup> The Court noted that it had previously used the categorical approach when states attempt to impose taxes on Indians on-reservation.<sup>131</sup> Justice Ginsburg indicated that it was settled law that a state’s tax is unenforceable against Indians on-reservation when the legal incidence of the tax is on the tribe, unless Congress instructs otherwise.<sup>132</sup> Alternatively, if the legal incidence of the tax falls on non-Indians, the state-imposed tax is enforceable if the *Bracker* balancing test tilts toward the state.<sup>133</sup> In this case, the Oklahoma excise tax, as originally designed, was invalid be-

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122. *Id.* at 142.

123. *Id.* (quoting *Williams v. Lee*, 358 U.S. 218, 220 (1959)).

124. *Id.* at 142-43.

125. *See id.* at 144.

126. *Id.* at 144-45.

127. *Id.*

128. *Id.* at 138, 149-50.

129. *See, e.g.*, *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134, 156-58 (1980); *Ramah Navajo Sch. Bd., Inc. v. Bureau of Revenue of N.M.*, 458 U.S. 832, 844-46 (1982); *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 184-87 (1989).

130. *Okla. Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450, 452-53 (1995).

131. *Id.* at 458.

132. *Id.* at 453, 458-59; *see McClanahan v. Az. Tax Comm’n*, 411 U.S. 164, 165 (1973); *Bryan v. Itasca County*, 426 U.S. 373, 376-77 (1976); *Bracker*, 448 U.S. at 145; *County of Yakima v. Confederated Tribes & Bands of Yakima Nation*, 502 U.S. 251, 257-58 (1992).

133. *Chickasaw Nation*, 515 U.S. at 459.

cause the legal incidence of the tax fell on the tribe.<sup>134</sup> The Court, however, instructed that the state could accomplish the taxation of Indians by amending the taxing statute to shift the legal incidence of the tax to a non-Indian.<sup>135</sup> Thus, in response to the *Chickasaw Nation* decision, Kansas changed its statute.

In 1995, the Kansas Legislature amended the Kansas motor-fuel tax law and placed the legal incidence of the tax on the distributor of the motor fuel.<sup>136</sup> On September 6, 1995, the Secretary of the Kansas Department of Revenue issued Notice 95-11, indicating that Kansas would enforce the 1995 statutory amendment and collect motor fuel tax from distributors when they sold fuel on Indian reservations.<sup>137</sup> This decision by Kansas sparked a flurry of litigation to determine if the Kansas motor-fuel tax law was a legitimate tax.

In response to the statutory amendment, Kansas retailers who were Indians, although not members of a Kansas tribe where their businesses were located, filed *Kaul v. Lafaver*<sup>138</sup> in state court.<sup>139</sup> The retailers sought a restraining order and injunction enjoining Kansas from collecting the motor fuel tax.<sup>140</sup> The Kansas Supreme Court held that the legal incidence of the tax fell on nontribal members, and therefore did not affect Indians.<sup>141</sup> Thus, the tax did not interfere with tribal self-government and the court allowed the tax.<sup>142</sup> Because this case failed, several actual Indian tribes initiated subsequent cases.

In *Sac and Fox Nation of Missouri v. Pierce*,<sup>143</sup> three federally recognized Indian tribes sued to enjoin Kansas from collecting tax on motor fuel.<sup>144</sup> The district court issued a temporary restraining order and preliminary injunction, but the United States Court of Appeals for the Tenth Circuit reversed.<sup>145</sup> The Tenth Circuit held that the legal incidence of the tax fell on distributors as provided in the taxing statute.<sup>146</sup> Further, the court indicated that the tax was not preempted and that there was insufficient evidence to balance federal, state, and tribal inter-

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134. *Id.* at 453, 462.

135. *Id.* at 460.

136. KAN. STAT. ANN. § 79-3408(c) (1997).

137. *See Kaul v. Lafaver*, 790 P.2d 60, 62 (1998).

138. 790 P.2d 60 (1998).

139. *Id.* at 62. The Kansas Supreme Court followed the same analysis and cited to *Chickasaw Nation*. *Id.* at 68-69. The Kansas Supreme Court accepted the categorical rule and balancing approach outlined in *Chickasaw Nation*. *Id.*; *see supra* text accompanying notes 130-135. It then determined that the legal incidence of the tax was on a non-Indian and the tax was enforceable. *Kaul*, 790 P.2d at 69.

140. *Kaul*, 790 P.2d at 63.

141. *Id.* at 69.

142. *Id.*

143. 213 F.3d 566 (10th Cir. 2000).

144. *Id.* at 569. The three Indian tribes were the Sac and Fox Nation of Missouri, the Iowa Tribe of Kansas and Nebraska, and the Kickapoo Tribe of Kansas. *Id.*

145. *Id.* at 570.

146. *Id.* at 580.

ests.<sup>147</sup> Thus, the court upheld the Kansas motor-fuel tax law. The ongoing conflict between the Indians and Kansas over the motor fuel tax would not end with *Sac and Fox Nation of Missouri*, however, because the Prairie Band Potawatomi Nation was not a party to that particular case. It would therefore file the next case seeking invalidation of the Kansas motor-fuel tax law.

#### IV. COURT'S OPINION

##### A. Majority

In *Potawatomi Nation*, the United States Supreme Court considered whether Kansas may apply its motor fuel tax to fuel sold by off-reservation distributors to Indian retailers for subsequent on-reservation sale.<sup>148</sup> In a 7-2 decision, the Supreme Court reversed the Tenth Circuit, upholding the Kansas motor fuel tax as applied because Kansas imposed the tax on a non-Indian distributor, and the tax arose from a transaction that occurred off-reservation.<sup>149</sup> As a result, the interest-balancing test set forth in *Bracker* was not applicable.<sup>150</sup> The majority reasoned that the Tenth Circuit misapplied the *Bracker* test.<sup>151</sup> The Court asserted that the test applies only where a state imposes authority over non-Indians engaging in transactions on Indian reservations, not when a state attempts to tax a non-Indian for a transaction that occurs off-reservation.<sup>152</sup>

Whether *Bracker* applies, and whether the activity or transaction that the state seeks to tax is immune from taxation, turns on the question of “*who* bears [the] legal incidence of the tax.”<sup>153</sup> The Court reiterated the law: “States are categorically barred from placing the legal incidence of an excise tax ‘on a tribe or tribal members for sales made inside Indian country’ without congressional authorization.”<sup>154</sup> The transaction is preempted if it occurs on-reservation and fails the *Bracker* interest-balancing test.<sup>155</sup>

The Court held that the tax was not preempted because the legal incidence of Kansas’s motor fuel tax fell on the distributor.<sup>156</sup> The Court adhered to the “dispositive language” of the Kansas statute, which specifically placed the legal incidence of the motor fuel tax on the distributor; even though the distributors are “entitled” to pass the tax

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147. *Id.* at 585.

148. *Wagnon v. Prairie Band Potawatomi Nation*, 126 S. Ct. 676, 680 (2005).

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.* at 681 (quoting *Okla. Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450, 458 (1995)).

154. *Id.* (quoting *Chickasaw Nation*, 515 U.S. at 459) (emphasis omitted).

155. *Id.*

156. *Id.* at 682.

onto the Indian retailer, they are not required to do so.<sup>157</sup> It was inappropriate to apply the *Bracker* interest-balancing test because that test was meant to address issues that arise when states assert authority for conduct on-reservation.<sup>158</sup> More specifically, in tax immunity cases, the *Bracker* test applies when the legal incidence of the tax falls on non-Indians conducting transactions *on* the reservation with Indians, and that courts have never applied the *Bracker* test when the state imposes a tax on non-Indians off the reservation.<sup>159</sup> Therefore, the Nation was not entitled to interest balancing under *Bracker* because the Kansas motor fuel tax precludes the Nation from imposing its own motor fuel tax.<sup>160</sup>

Finally, the Court rejected the Nation's argument that the tax is "impermissibly discriminatory" because the Kansas motor fuel statute provided exemptions to other sovereigns, but not to Indian sovereigns.<sup>161</sup> The statute did not provide an exemption to the Nation because it was not similarly situated to the sovereigns that were exempted.<sup>162</sup> The Indian tribe was not similarly situated because Kansas used the revenue from its fuel tax to maintain the roads and bridges on the Nation's reservation and the main highway used by the Nation's casino and fuel customers.<sup>163</sup> Kansas offered no such services to other exempt sovereigns, such as other states and the federal government.<sup>164</sup> Furthermore, the intrastate burden falls equally on the retailers regardless of whether they are located on a reservation.<sup>165</sup>

### B. Justice Ginsburg's Dissent

Justice Ginsburg dissented and asserted that the majority failed to understand and apply the *Bracker* interest-balancing test, which was key in *Potawatomi Nation*.<sup>166</sup> She insisted that the question in *Bracker* was whether the burdens imposed on Indians should preempt an otherwise lawful tax levied on non-Indians.<sup>167</sup> In *Bracker*, Arizona attempted to impose fuel and vehicle licensing taxes on a non-Indian who contracted with the tribe to harvest timber from the Indian reservation.<sup>168</sup> Justice Ginsburg clarified that *Bracker* held that the tax was impermissible because the economic burden of the tax fell on the Indians.<sup>169</sup> Further-

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157. *Id.*

158. *Id.* at 686.

159. *Id.* at 681, 686.

160. *Id.* at 688.

161. *Id.* at 689.

162. *Id.*

163. *See id.*

164. *Id.*

165. *Id.* at 688.

166. *Id.* at 690 (Ginsburg, J., dissenting).

167. *Id.*

168. *Id.*

169. *Id.*

more, when the Court balanced the interests of the state, tribe, and federal government, the Court concluded that the state was unable to justify the tax on grounds other than raising revenue.<sup>170</sup> The state's interest in revenue raising was weaker than the economic burden on the Indians and the federal interest in regulating the harvesting and sale of timber.<sup>171</sup> The Court in *Bracker* therefore invalidated the tax, and Ginsburg asserted that *Potowatomi Nation* should have adopted the same reasoning.<sup>172</sup>

Justice Ginsburg also would have invalidated the Kansas motor fuel tax because the statutory placement of the legal incidence of the tax was not as certain as the Court held. Ginsburg illustrated what she considered to be a flaw in the statute, and explained that the statute *first* indicates that the tax is "hereby imposed on the use, sale or delivery of all motor vehicle fuels . . . used, sold or delivered in this state for any purpose whatsoever . . . ."<sup>173</sup> The statute then stated that the "the incidence of [the] tax is imposed on the distributor of the first receipt of the motor fuel."<sup>174</sup> She argued, therefore, that the incidence of the tax was ambiguous.<sup>175</sup>

Justice Ginsburg rectified the ambiguity by examining the exemptions in the statute.<sup>176</sup> Kansas exempted the following from the motor fuel tax: (1) out of state sales, (2) sales to the United States, (3) sales to other distributors, (4) sales to United States government contractors, and (5) lost or destroyed fuel.<sup>177</sup> Justice Ginsburg insisted that the majority opinion was flawed because, when the distributor nets all the exclusions, the Kansas motor fuel tax is levied not on the distributor, "but effectively *only* on fuel actually *resold* by the distributor to an in-state nonexempt purchaser."<sup>178</sup> This supported the proposition that the state was imposing the tax on the use, sale, or delivery, and therefore in this case, on the Indians.<sup>179</sup>

Justice Ginsburg further attacked the majority opinion by explaining that Kansas and the Court misread *Oklahoma Tax Commission v. Chickasaw Nation*.<sup>180</sup> She indicated *Chickasaw Nation* held that a state cannot enforce its tax absent clear congressional authority when the legal incidence of the tax falls on an Indian or Indian tribe for sales inside

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170. *Id.*

171. *Id.*

172. *Id.*

173. *Id.* at 691 (quoting KAN. STAT. ANN. § 79-3408(a) (Supp. 2003); KAN. STAT. ANN. § 79-3409 (Supp. 2003)).

174. *Id.* (quoting KAN. STAT. ANN. § 79-3408(c) (Supp. 2003)).

175. *Id.*

176. *Id.* at 691-92.

177. *Id.* at 689.

178. *Id.* at 692.

179. *Id.*

180. *Id.*

Indian Country.<sup>181</sup> She explained further that this bright-line standard is sensitive to Indian sovereignty, and that the Court recognized that Indian sovereignty is subordinate to the federal government, but not the states.<sup>182</sup> When the legal incidence of a tax is placed on non-Indians for sales made within Indian Country, *Chickasaw Nation* held that instead of an absolute test that places dispositive weight on the legal incidence of the tax, the Court should apply a test that balances the interests of state, federal, and tribal governments.<sup>183</sup>

Justice Ginsburg described further Kansas's misinterpretation of *Chickasaw Nation*.<sup>184</sup> She explained that Kansas misunderstood the legal significance of the statutory tax shift from the distributor to the retailer.<sup>185</sup> *Chickasaw Nation* held "only that a State could shift the legal incidence [of a tax] to non-Indians to avoid the categorical bar" of the tax when the state imposes it directly on the Indians.<sup>186</sup> Most importantly, it instructed that rewriting a statute to shift the legal incidence of a tax off Indians would "trigger—not foreclose—interest balancing."<sup>187</sup>

Finally, Justice Ginsburg criticized the majority for insisting that its Indian tax immunity cases advocate not applying the *Bracker* interest-balancing test to the Kansas motor fuel tax.<sup>188</sup> Justice Ginsburg clarified that Indian sovereignty and self-government strives to attain a balance between the interests of the Indians, the federal government, and the state.<sup>189</sup> She then asserted that no bright-line test is capable of balancing these interests when states seek to levy taxes on non-Indians when there is an impact to on-reservation activities.<sup>190</sup> As long as the legislature officially places the legal incidence on non-Indians, the tribes lose.<sup>191</sup>

## V. COMMENTARY

The power to tax is one of the distinct attributes of sovereign governments, and thus as sovereign governments, Indian tribes have the power to tax.<sup>192</sup> A sovereign Indian tribe, the Nation, imposed a tax on the fuel sold at its tribally owned on-reservation gas station.<sup>193</sup> Kansas imposed a tax on the same fuel by placing the legal incidence of the tax

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181. *Id.*

182. *Id.*

183. *Id.* at 692-93.

184. *Id.* at 693.

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* at 694.

189. *Id.* at 694-95.

190. *Id.* at 695.

191. *Id.*

192. Kickingbird et al., *supra* note 64, at 5.

193. *Prairie Band Potawatomi Nation v. Richards*, 241 F. Supp. 2d 1295, 1298 (2003).

on the distributor.<sup>194</sup> In effect, this is double taxation, which creates inequities that courts would not tolerate “in the multistate or international tax arena[.]”<sup>195</sup>

The Supreme Court in *Potawatomi Nation* could have used substance over form—a judicially created doctrine courts often use to adjudicate tax cases based on the economic substance of a transaction rather than its legal form—to invalidate the Kansas motor-fuel tax law.<sup>196</sup> This comment will illustrate how courts have repeatedly used the judicial doctrine of substance over form to disallow taxpayer positions, even when the transaction is within the literal meaning of the statutory language.<sup>197</sup> Then, this comment will analyze the Kansas motor-fuel tax law using substance over form as opposed to form over substance, which the Supreme Court used in *Potawatomi Nation*.

#### A. *Substance over Form – Protection of the Legitimacy of the Income Tax*

According to the Supreme Court, the dispositive analysis in adjudicating Indian tax immunity cases is determining where the legal incidence of the tax falls.<sup>198</sup> In tax law, “[t]he legal incidence of the tax is merely concerned with the party that is legally responsible for [the] tax . . .”<sup>199</sup> Alternatively, economic incidence “denotes the party to a transaction . . . who is unable to pass along the burden of the tax,” and who is ultimately responsible for paying the tax.<sup>200</sup> Courts generally ignore economic incidence in Indian tax immunity cases.<sup>201</sup> Instead, courts determine where the legal incidence of the tax falls whether expressly assigned statutorily or from a “fair interpretation of the taxing statute as written and applied . . .”<sup>202</sup> When the legal incidence of the tax falls on

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194. *Id.*

195. Mark J. Cowan, *Double Taxation in Indian Country: Unpacking the Problem and Analyzing the Role of the Federal Government in Protecting Tribal Governmental Revenues*, 2 PITT. TAX REV. 93, 94 (2005).

196. Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 FLA. TAX REV. 492, 493, 495 (1995); see *Frank Lyon Co. v. United States*, 435 U.S. 561, 572-73 (1978).

197. See, e.g., *Diedrich v. Comm’r*, 457 U.S. 191, 195 (1982) (noting that when applying substance over form, courts look to the economic realities of the transaction); *Coltec Indus. v. United States*, 454 F.3d 1340, 1343, 1352 (Fed. Cir. 2006) (explaining that the economic substance doctrine dictates that transactions that lack substance are disregarded even if they comply literally with the tax statute); *Dow Chem. Co. v. United States*, 435 F.3d 594, 599 (6th Cir. 2006) (indicating that a transaction formally complying with the tax statute will be disallowed if it lacks substance); *Microsoft Corp. v. Franchise Tax Bd.*, 139 P.3d 1169 (Cal. 2006) (rationalizing that the nature of the transaction is the court’s concern, not the label).

198. *Okla. Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450, 458-59 (1995).

199. Robert William Alexander, *The Collision of Tribal Natural Resource Development and State Taxation: An Economic Analysis*, 27 N.M. L. REV. 387, 409 n.173 (1997).

200. *Id.*

201. See *Chickasaw Nation*, 515 U.S. at 459.

202. *Wagnon v. Prairie Band Potawatomi Nation*, 126 S. Ct. 676, 682 (2005) (quoting *Cal. Bd. of Equalization v. Chemehuevi Tribe*, 474 U.S. 9, 11 (1985)).

Indians, the state cannot enforce the tax.<sup>203</sup> When the legal incidence is on non-Indians, however, no per se rule prevents the tax.<sup>204</sup> In the latter situation, the *Bracker* interest-balancing test is triggered, and when the balance favors the state, the tax is valid and enforceable.<sup>205</sup> These seemingly bright-line formalistic rules validate a tax based solely on its legal incidence and allow the legislature to elevate the form of the law over its substance and shift the economic incidence of tax to Indian tribes.

Substance over form, as used in the federal tax context, allows courts to ignore the text of a statute if a transaction appears questionable, even if it fits within the text of the statute.<sup>206</sup> The doctrine originated in *Helvering v. Gregory*,<sup>207</sup> where the court held that the taxpayer's transaction lacked substance and, therefore, was a sham.<sup>208</sup> The taxpayer sought to avoid tax by disposing of all of the stock of a wholly owned corporation without recognizing dividend income.<sup>209</sup> If the taxpayer sold all of the shares of the wholly owned corporation, the government would have required the corporation to pay tax on the gain and the taxpayer to pay tax at ordinary rates on the dividend income.<sup>210</sup> To reduce the overall tax burden, the taxpayer created a new corporation to which the wholly owned corporation transferred all its shares of stock.<sup>211</sup> The new corporation then issued all of its shares to the taxpayer, and the taxpayer dissolved the corporation.<sup>212</sup> The taxpayer received the shares of the wholly owned company as a liquidating dividend, which the taxpayer sold at a reduced tax liability.<sup>213</sup> The court recognized that the taxpayer followed the text of the statute but not the purpose, stating that "the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all

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203. *Chickasaw Nation*, 515 U.S. at 459.

204. *Id.*

205. *Id.*

206. Allen D. Madison, *The Tension Between Textualism and Substance-Over-Form Doctrines in Tax Law*, 43 SANTA CLARA L. REV. 699, 700 (2003).

207. 69 F.2d 809 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).

208. *Id.* at 811.

209. *Id.* at 810.

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.* The taxpayer in *Helvering* argued that the transaction qualified as a reorganization under the Revenue Act of 1928. *Id.* The applicable statute was section 112, which stated "[n]o gain shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization." 26 U.S.C. § 112(b)(3) (1952). The Code defined "reorganization" as "a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred . . ." 26 U.S.C. § 112(g)(1)(D) (1952). The taxpayer's theory was that the transfer of the wholly owned corporation to the newly formed corporation was a reorganization and that it fell "within section 112(g) of that act, 26 USCA 2112 (g), and that her 'gain' should not be 'recognized,' because [ ] the shares were 'distributed, in pursuance of a plan of reorganization.'" *Helvering*, 69 F.2d at 810.

appear, and which all collectively create.”<sup>214</sup> Thus, courts began to use the substance-over-form doctrine to decide cases involving tax statutes.

Today, courts use the substance-over-form doctrine to deny taxpayers’ deductions to transactions that lack substance.<sup>215</sup> Courts are concerned with the “nature of the transaction [as opposed to] the label attached” to the transaction.<sup>216</sup> Additionally, substance over form dictates that courts look at the economic realities of the transaction and not the form of the transaction.<sup>217</sup> Often the taxpayer’s transaction is within the literal statutory meaning, but because it lacks economic substance, it is invalid.<sup>218</sup> Whereas textualism dictates that the ordinary meaning of the words in the statute accurately reflect the statutory purpose, the substance-over-form doctrine, through the use of purposivism, often requires a non-literal interpretation of a statute to enforce the overall purpose.<sup>219</sup> Typically, a conflict arises between textualism and purposivism when a taxpayer wants a literal interpretation of a tax statute (form over substance) and the government wants to deviate from form for a purposive approach (substance over form).<sup>220</sup>

Purposivism and substance over form are completely the opposite of textualism.<sup>221</sup> Textualism dictates that courts should interpret statutes based on the meaning of the text.<sup>222</sup> Purposivism and substance over form, however, allow courts to ignore the textual meaning of the statute and instead look to the statutory purpose and the economic substance of a transaction.<sup>223</sup> In tax law, substance over form protects the government and the tax system.<sup>224</sup> Without substance over form, the income tax fails.

In tax, “literal interpretations [of statutes] are the keystone of tax shelters.”<sup>225</sup> An abusive tax shelter “is a transaction which is designed to technically comply with the letter of the law, but which produces tax savings that are inappropriate to the underlying purposes of the statutory scheme and inconsistent with the economic reality of the transac-

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214. *Helvering*, 69 F.2d at 810-11.

215. David B. McGinty, *Economic Substance, Business Purpose, and Tax Avoidance in Section 351 Contingent Liability Transactions After Black & Decker, Coltec, and Hercules*, 36 CUMB. L. REV. 1, 28-29 (2006); see cases cited *supra* note 196.

216. *Microsoft Corp. v. Franchise Tax Bd.*, 139 P.3d 1169, 1176 (Cal. 2006).

217. *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1978).

218. See, e.g., *Coltec Indus. v. United States*, 454 F.3d 1340, 1343 (Fed. Cir. 2006).

219. *Geier*, *supra* note 196, at 495. The common law substance-over-form doctrine is used in federal tax analysis to look at the economic realities of a transaction. *Id.* Courts use purposivism, a statutory interpretation method, to accomplish the goals of substance over form. *Id.*

220. *Id.*

221. *Madison*, *supra* note 206, at 700.

222. *Id.* at 700-01.

223. *Id.* at 701.

224. See *Geier*, *supra* note 196, at 495.

225. Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 20 (2004).

tion.”<sup>226</sup> Textualism allows attorneys and tax advisors to structure transactions so that they fit within the literal form of the statute but which are questionable based on the statute’s purpose, as determined through legislative history.<sup>227</sup> Because of these transactions, the government suffers a loss of tax revenue of between ten and twenty-four billion dollars per year, which will have long-term effects on the tax system.<sup>228</sup> Allowing attorneys to structure such transactions using form over substance could eliminate the income tax.<sup>229</sup> An example that illustrates this is *Helvering*. If the court in that case would have allowed the taxpayer to structure the transaction as a reorganization to avoid the dividend as planned, it would have created a loophole so large that it could have eliminated future dividend income.<sup>230</sup> Using purposivism instead of textualism allowed the court to keep dividend income intact. Additional examples illustrate how purposivism and the substance-over-form doctrine protect the legitimacy of the income tax system.

Two of the most famous controversies in the substance-over-form arena following *Helvering* involved the treatment of gain when taxpayers transferred property encumbered by liabilities.<sup>231</sup> In *Crane v. Commissioner*,<sup>232</sup> a deceased party transferred property (an apartment building) to his wife through a will.<sup>233</sup> At that time, the property’s fair market value was \$262,000; however, a \$262,000 liability (\$255,000 mortgage and \$7,000 interest) encumbered the property and ultimately left the taxpayer with zero equity.<sup>234</sup> The recipient taxpayer assumed this non-recourse liability and then operated the apartment building for seven years before selling it for \$2,500.<sup>235</sup> Upon sale, the recipient taxpayer claimed that she had inherited an equity interest in the property with zero value, and accordingly claimed a zero basis in the property.<sup>236</sup> The Court held, however, that the recipient taxpayer’s basis was the original \$262,000—the fair market value of the property.<sup>237</sup> Thus, the gain was not the \$2,500 received for the property, but was \$23,500.<sup>238</sup>

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226. *Id.* at 20.

227. *Id.* at 2, 29.

228. *Id.* at 3.

229. *Id.*

230. See *Helvering v. Gregory*, 69 F.2d 809 (2d Cir. 1934); Cunningham & Repetti, *supra* note 225, at 3, 26.

231. Michael Livingston, *Practical Reason, “Purposivism,” and the Interpretation of Tax Statutes*, 51 TAX L. REV. 677, 691 (1998).

232. 331 U.S. 1 (1947).

233. *Id.* at 3.

234. *Id.* at 3-4.

235. *Id.* at 4.

236. *Id.*

237. *Id.* at 11. Generally, basis of property is the taxpayer’s cost to acquire the property adjusted by the depreciation allowed. I.R.C. § 1012, 1016(a)(2) (1994).

238. *Crane*, 331 U.S. at 4-5. For simplicity, the numbers in *Crane* have been rounded. The gain is calculated by adding the sales price of \$2,500 to the mortgage relief of \$255,000 and subtracting the adjusted basis of \$234,000. The Code provides that “[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis . . . .” I.R.C. §

Thirty-six years later, the Supreme Court decided *Commissioner v. Tufts*,<sup>239</sup> which involved similar facts to *Crane*. In *Tufts*, however, the taxpayer transferred property encumbered with a liability that exceeded the fair market value of the property.<sup>240</sup> The Court held that when a taxpayer sells or otherwise disposes of encumbered property and the purchaser assumes the liability, the amount realized includes the amount of liability relief regardless of whether the amount exceeds the fair market value of the property.<sup>241</sup>

The statute involved in both *Crane* and *Tufts* was the same as current section 1001(b) of the Internal Revenue Code (Code), which states that the amount realized on the “disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.”<sup>242</sup> This statute does not explicitly state that taxpayers who transfer property subject to debt must include the amount in the amount realized, which could result in taxable income.<sup>243</sup> A textualist, therefore, would argue that amount realized should not include the debt.<sup>244</sup> *Crane* and *Tufts*, however, are purposive decisions where the Court has placed substance over form to prevent taxpayers from being unjustly enriched through loan provisions.<sup>245</sup>

A more blatant and radical purposive decision is *Albertson’s Inc. v. Commissioner*<sup>246</sup> (*Albertson’s II*), decided on rehearing by the United States Court of Appeals for the Ninth Circuit.<sup>247</sup> The taxpayer attempted to deduct interest on nonqualified pension plan contributions before pension plan participants received their deferred compensation from the plan and were taxed on it.<sup>248</sup> The Code seemingly permitted these deductions under section 163(a), which allows a deduction for “interest paid or accrued within the taxable year on indebtedness.”<sup>249</sup> Section 404, however, denies employer deductions for compensation paid to employees in nonqualified pension plans under sections 162 and 212, but does not expressly mention section 163.<sup>250</sup> On the first hearing of *Albertson’s Inc. v. Commissioner (Albertson’s I)*,<sup>251</sup> the Ninth Circuit adopted a literal approach and held that Albertson’s was free to deduct

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1001 (a) (1994). Amount realized is the “sum of any money received plus the fair market value of the property (other than money) received.” I.R.C. § 1001(b) (1994).

239. 461 U.S. 300 (1983).

240. *Id.* at 301-02. The loan was \$1,851,500 and the fair market value of the property was \$1,400,000. *Id.* at 302-03.

241. *Id.* at 317.

242. I.R.C. § 1001(b) (1994).

243. Livingston, *supra* note 231, at 693.

244. *Id.*

245. *Id.* at 691.

246. 42 F.3d 537 (9th Cir. 1994).

247. Livingston, *supra* note 231, at 712.

248. *Albertson’s II*, 42 F.3d at 538.

249. I.R.C. § 163(a) (1994).

250. Livingston, *supra* note 231, at 713-14.

251. 38 F.3d 1046 (9th Cir. 1993).

the expenses as interest under section 163 “[b]ased on a plain-language reading of the statute . . .” and section 404 did not preclude the deduction.<sup>252</sup> In response to intense criticism, however, the Ninth Circuit agreed to rehear the case.<sup>253</sup>

In *Albertson’s II*, the court reversed the *Albertson’s I* decision concluding that Congress’s purpose behind section 404 was to encourage qualified plans as opposed to nonqualified plans.<sup>254</sup> The Ninth Circuit, therefore, held that “despite the literal wording of the statute,” Congress’s purpose behind section 404 was to prevent interest deductions until the nonqualified plan participant received benefits.<sup>255</sup> *Albertson’s II* is a radical example of purposivism, where “the court frankly admits that its decision cannot be reconciled with the statutory language,” but puts substance over form to benefit the government and accomplish the purpose of the statute.<sup>256</sup>

These federal tax cases demonstrate that courts often use substance over form to protect the legitimacy of the income tax system. Denying transactions that lack substance allows a court to adjudicate tax cases based on the economic reality of the transaction and ensures that taxpayers abide by the purpose of the particular taxing statute. Without substance over form in income tax, the bottom drops out of the income tax laws particularly because a good tax lawyer can structure around every tax law with a few transactions.<sup>257</sup>

### *B. Substance over Form – Protection of Indian Sovereignty*

*Potawatomi Nation*, on the other hand, is a decision where the Court put form over substance to benefit Kansas because the tax statute has no relationship to economic realities. Although not a case based on the Code, *Potawatomi Nation* could have used the common law doctrine of substance over form to evaluate the policy underlying the Kansas motor-fuel tax law. The statute specifies that “the incidence of [the tax] is imposed on the distributor of the first receipt of the motor fuel.”<sup>258</sup> The Court determined that because the statute places the legal incidence on a non-Indian, the motor fuel tax was valid.<sup>259</sup> In this case, the Court took a textualist approach by deciding the case on the plain-language of the statute.<sup>260</sup> This approach is lacking, however, because the state can

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252. *Id.* at 1054.

253. *Albertson’s Inc. v. Comm’r*, 12 F.3d 1529 (9th Cir. 1993), *Livingston*, *supra* note 231, at 712.

254. *Albertson’s Inc. v. Comm’r (Albertson’s II)*, 42 F.3d 537, 540 (9th Cir. 1994).

255. *Id.* at 543, 546.

256. *Livingston*, *supra* note 231, at 716.

257. *Cunningham & Repetti*, *supra* note 225, at 2-3.

258. *Wagon v. Prairie Band Potawatomi Nation*, 126 S. Ct. 676, 680, 682 (2005) (quoting KAN. STAT. ANN. § 79-3408(c) (Supp. 2003)).

259. *Id.*

260. *Id.*

manipulate any tax statute so that the legal incidence falls on a non-Indian under the Court's definition of legal incidence.<sup>261</sup> Under such an analysis, the Court would uphold a tax even if the economic burden is on the Indians as long as the legal incidence, as determined under a textualist analysis, is not.<sup>262</sup> In its textualist decision, the Court ignored the common law principle of substance over form and instead elevated form over substance.<sup>263</sup>

If such a textualist ruling stands, the bottom drops out of economic incidence because states can structure statutes around the substance-over-form doctrine without limit and without regard for Indian sovereignty. With the form over substance ruling in *Potawatomi Nation*, not only can state legislatures structure fuel statutes to tax Indians and invade their sovereignty, but legislatures can now manipulate any state statute to tax Indians. For example, states cannot currently charge Indians state sales tax for the purchase of goods on-reservation whether the seller is an Indian or non-Indian.<sup>264</sup> Ignoring substance over form, however, legislatures can manipulate state sales tax statutes to place the legal incidence of the tax on a non-Indian, but allow the non-Indian to pass the tax onto the Indian through the sale. From a textualist approach and pursuant to the *Potawatomi Nation* decision, the tax would fit within the form of the statute and be upheld. From the substance-over-form approach, however, the tax would be on Indians and would be an affront to their sovereignty. Thus, when the Court ignored the common law substance-over-form doctrine, it failed to protect Indian sovereignty.

Examining the substance and economic reality of the Kansas tax would provide a better outcome to the case. The substance-over-form analysis in *Potawatomi Nation* is two-fold. First, from a purposive approach, the purpose of the statute seems clear—to tax Indians through form over substance by statutorily placing the legal incidence of the motor fuel tax on a non-Indian, something that Kansas could not otherwise legally accomplish. Because the Supreme Court invalidated a tax statute similar to Kansas's in *Oklahoma Tax Commission v. Chickasaw Nation*, the Kansas Legislature simply amended the Kansas motor-fuel tax law to conform to *Chickasaw Nation's* direction. It instructed states how to structure statutes to tax Indians using semantics when it stated, “[I]f a State is unable to enforce a tax because the legal incidence of the impost is on Indians or Indian Tribes, the State generally is free to

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261. Cowan, *supra* note 195, at 109.

262. *Id.*

263. See *Potawatomi Nation*, 126 S. Ct. at 682.

264. See *Moe v. Confederated Salish and Kootenai Tribes*, 425 U.S. 463, 482 (1976); *Wofford v. Wash. State Dep't. of Revenue*, 622 P.2d 1278, 1279 (Wash. Ct. App. 1980), *cert. denied*, 454 U.S. 965 (1981).

amend its law to shift the tax's legal incidence."<sup>265</sup> On September 6, 1995, the Secretary of the Kansas Department of Revenue issued Notice 95-11 indicating that Kansas would enforce the 1995 statutory amendment and collect motor fuel tax from distributors when they sold fuel on Indian reservations.<sup>266</sup> Kansas followed the Court's instruction, but the economic effect of the motor fuel tax was the same as it was before 1995, only the form had changed. Justice Ginsburg noted that "so long as the State officially places the burden on the non-Indian distributor in cases of this order, the Tribe loses."<sup>267</sup> A textualist interpretation of the Kansas motor-fuel tax law allows Kansas to achieve such a result.

Second, the economic incidence of the tax is on the Indians. The Kansas motor-fuel tax law places the legal incidence on the distributor, but allows the distributor to pass the tax directly to retailers, such as Nation Station.<sup>268</sup> If a business were able to pass costs onto someone else, then it would likely do so simply to avoid the additional expenditure. At oral arguments before the Supreme Court, Kansas represented that the distributor was in fact passing the costs of the Kansas motor-fuel tax law to the Nation.<sup>269</sup> Regardless of where the legal incidence is, this pass-thru tax regime places the economic incidence on the Indians. Because of this pass-thru tax, Kansas precludes the Nation from imposing its own tax because the two taxes cannot coexist.<sup>270</sup>

According to the Nation's economic expert, because the gasoline supply is highly elastic, the Nation cannot charge prices high enough to cover both its and Kansas's fuel tax.<sup>271</sup> Nation Station would operate at a substantial loss because no one would likely fill up at its pumps when other gas in the market is \$0.16 to \$0.18 less expensive.<sup>272</sup> Because the Kansas fuel tax and the Nation's fuel tax are mutually exclusive, the Nation would suffer because it would no longer have the revenue to maintain and build roads.<sup>273</sup> If the Nation attempted to collect both taxes, its

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265. Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 460 (1995).

266. Kaul v. Lafaver, 790 P.2d 60, 62 (1998); see Kelley Gaines Stoner & Casey Ross-Petherick, *The "Who and Where" Means the State Takes All: State Taxation Crosses into Indian Country*, 30 AM. INDIAN L. REV. 385, 390 (2005).

267. *Potawatomi Nation*, 126 S. Ct. at 695.

268. KAN. STAT. ANN. § 79-3408(c) (1997). The statute states that "[e]very distributor paying such tax or being liable for the payment shall be entitled to charge and collect an amount, including the cost of doing business that could include such tax on motor-vehicle-fuels . . . sold or delivered by such distributor, as a part of the selling price." KAN. STAT. ANN. § 79-3409 (Supp. 2005).

269. Transcript of Oral Argument at 25, *Potawatomi Nation*, 126 S. Ct. 676 (No. 01-1015).

270. *Id.*

271. Joint Appendix at 34, *Potawatomi Nation*, 126 S. Ct. 676 (No. 04-631). Justice Ginsburg noted that Kansas submitted no evidence at trial that either contradicted the Nation's expert or showed that the information was exaggerated. *Potawatomi Nation*, 126 S. Ct. at 696 (Ginsburg, J., dissenting).

272. See *Potawatomi Nation*, 126 S. Ct. at 690. The Nation's attorney indicated to the Court that during litigation, Nation Station was forced to operate at a loss because of the double tax. Transcript of Oral Argument at 25, *Potawatomi Nation*, 126 S. Ct. 676 (No. 01-1015).

273. Joint Appendix at 34-35, *Potawatomi Nation*, 126 S. Ct. 676 (No. 04-631).

business would be reduced to nothing.<sup>274</sup>

If the Supreme Court had used its judicially created doctrine of substance over form, as it should have, *Potawatomi Nation* would have been decided in favor of the Nation. Typically, in substance over form, conflicts arise between the language of the statute and the “‘tax logic’ or policy of the case.”<sup>275</sup> Generally, the “logical” substance argument favors the government whereas the literal language and form favors the taxpayer.<sup>276</sup> Of course, the opposite is true in *Potawatomi Nation*; the substance favors Indians. Without substance over form in state tax analysis, Indian tribes’ sovereignty erodes as they begin to lose the ability to impose their own taxes.

## VI. CONCLUSION

The relationship between Indians and the states has been controversial, with disagreements arising over sovereignty.<sup>277</sup> The most divisive conflicts arise when states attempt to impose their taxes on Indians within Indian Country.<sup>278</sup> The most recent controversy between Kansas and the Indians resulted in the Supreme Court holding that the Kansas motor-fuel tax law was a valid tax. The *Potawatomi Nation* Court, however, undermined tribal sovereignty by ignoring the judicially created doctrine of substance over form. When applied to tax disputes involving the Code, substance over form protects the legitimacy of the income tax system. Courts can also analyze whether a state’s law violates this doctrine. A substance-over-form analysis applied to the Kansas motor-fuel tax law would protect Indian sovereignty and invalidate the Kansas tax. While the legal incidence of the tax (form) is on a non-Indian distributor, the economic reality (substance) is that the burden falls on Indians.

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274. *Id.* at 39.

275. Livingston, *supra* note 231, at 691.

276. *Id.*

277. Luna, *supra* note 10, at 455.

278. Carleton, *supra* note 13, at 253 (noting that Congress has not passed legislation addressing the state’s ability “to tax individuals, activities, or income within Indian Country”).