

## Memorandum

To: Honorable Betty T. Yee, Chairwoman  
Honorable Judy Chu, Ph.D., Vice Chair  
Honorable Bill Leonard, Second District  
Honorable Michelle Steele, Third District  
Honorable John Chiang, Controller

Date: August 3, 2007

From: Kristine Cazadd  
Chief Counsel 

Subject: **Board Meeting – August 14, 2007**  
**Chief Counsel Matters – Item M1**

### **Cooperation with Native American Tribes – Taxation of Cigarettes & Tobacco Products**

At the July 17, 2007, Board meeting in Sacramento, staff gave an oral report regarding its desire to work cooperatively with Native American tribes in California to promote the collection of taxes under the Cigarette and Tobacco Products Tax Law. At this meeting, the Board directed staff to provide a written discussion of California's legal authority to impose on the tribes the obligation to collect these taxes from non-Indian purchasers. This memorandum discusses the relevant authorities and confirms that California is authorized under federal law to impose such a collection obligation. This memorandum further confirms that, as a practical matter, a cooperative effort with the tribes would provide the most effective approach for promoting the tribes' fulfillment of this obligation.

Such a cooperative effort with the tribes would facilitate the tax compliance of non-Indians who purchase cigarettes and tobacco products within Indian country<sup>1</sup> and would help to maintain a competitive market for licensed California distributors and for California retailers selling outside Indian country.<sup>2</sup> Additionally, such cooperation would be consistent with California's ongoing diligent enforcement of its responsibilities under the Master Settlement Agreement (MSA).<sup>3</sup>

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<sup>1</sup> The term "Indian country," as Congress comprehends that term, includes "formal and informal reservations, dependent Indian communities, and Indian allotments, whether restricted or held in trust by the United States." (18 U.S.C. § 1151; *Oklahoma Tax Commission v. Chicasaw Nation* (1995) 515 U.S. 450, 453, fn. 2.)

<sup>2</sup> Untaxed cigarettes would include any without California excise tax stamps that are sold to non-Indians.

<sup>3</sup> Non-MSA compliant cigarettes are those cigarettes that do not appear on the California Tobacco Directory, published by the Office of the Attorney General, and are not allowed to be sold in the State of California. (Rev. & Tax. Code, § 30165.1, subd. (e).) Excise tax collected on sales of cigarettes also constitutes a factor used in calculating escrow payments required to be made by certain tobacco product manufacturers to the State of California. (Health & Saf. Code, §§ 104556, subd. (j), 104557.) Additionally, enforcement of the escrow payment requirement impacts the state's MSA payments. Thus, the Board's enforcement responsibilities with regard to

Accordingly, unless the Board directs otherwise at the August 14, 2007, meeting, staff intends to send a letter to the tribes, inviting them to meet and confer with staff on these important matters.

Under federal law, California may impose the obligation on the tribes to collect and remit California's excise tax for untaxed cigarettes or tobacco products sold on Indian reservations to non-Indians. As the United States Supreme Court (hereafter Supreme Court) held in *Moe, Sheriff, et al. v. Confederated Salish and Kootenai Tribes of the Flathead Reservation* (1976) 425 U.S. 463, 483:

The State's requirement that the Indian tribal seller collect a tax validly imposed on non-Indians is a minimal burden designed to avoid the likelihood that in its absence non-Indians purchasing from the tribal seller will avoid payment of a concededly lawful tax. . . . We see nothing in this burden which frustrates tribal self-government . . . or runs afoul of any congressional enactment dealing with the affairs of reservation Indians . . . . We therefore agree with the District Court that to the extent that the "smoke shops" sell to those upon whom the State has validly imposed a sales or excise tax with respect to the article sold, the State may require the Indian proprietor simply to add the tax to the sales price and thereby aid the State's collection and enforcement thereof.

Four years later, the Supreme Court reaffirmed this holding. (*Wash. v. Confederated Tribes of Colville Indian Reservation* (1980) 447 U.S. 134, 150-151, 159 (*Colville*).)<sup>4</sup> In *Colville*, the Supreme Court also upheld the imposition on the tribes of detailed recordkeeping requirements with respect to exempt and nonexempt sales for audit purposes. (*Id.* at pp. 159-160.)

In 1985, the Supreme Court, in *California State Board of Equalization v. Chemeheuvi Indian Tribe* (1985) 474 U.S. 9 (*Chemeheuvi*), specifically held that the California could impose a collection obligation on the tribes under California's Cigarette and Tobacco Products Tax Law:

We hold that the legal incidence of California's cigarette tax falls on the non-Indian consumers of cigarettes purchased from respondent's [tribe's] smoke shop, and that petitioner [California] has the right to require respondent to collect the tax on petitioner's behalf.

(*Chemeheuvi, supra*, 474 U.S. at p. 12; see Rev. & Tax. Code, §§ 30107, 30108.) Since *Chemeheuvi*, the Supreme Court has continued to reaffirm the states' right to impose such a collection obligation on the tribes. (See, e.g., *Okla. Tax Com. v. Citizen Band Potawatomi*

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cigarette sales have a dual impact on revenue (namely, on the amount of tax collected and on the amount of the MSA payments received by the state).

<sup>4</sup> Absent authorization from Congress (which has not heretofore been given), the tribes cannot be taxed for their distributions within Indian country under federal law. (*Moe, supra*, 425 U.S. 463, 475-476.) If an Indian tribe or an individual Indian sells untaxed cigarettes or tobacco products to non-Indians within Indian country, the incidence of the excise tax would fall on the non-Indian consumer. (See Rev. & Tax. Code, §§ 30008, 30009.) If the tribe or other Indian does not collect and remit the tax to the Board, the non-Indian consumer remains liable for the tax.

*Indian Tribe of Okla.* (1991) 498 U.S. 505 (*Potawatomi*)). In light of the Supreme Court's consistent upholding of this right, it would appear to be a matter of settled law that California has the legal authority to impose on the tribes the obligation to collect cigarette and tobacco products taxes from non-Indian purchasers.

However, because the tribes enjoy federally conferred sovereign immunity from state suit, as a practical matter, to the extent any tribe was unwilling to fulfill its legal obligations to California, California could not sue that tribe to enforce its legal rights. (See, e.g., *Kiowa Tribe of Okla. v. Manufacturing Technologies, Inc.* (1998) 523 U.S. 751, 756-760.) As the Supreme Court explained in *Potawatomi*:

In view of our conclusion with respect to sovereign immunity of the Tribe from suit by the State, Oklahoma complains that, in effect, decisions such as *Moe* and *Colville* give them a right without any remedy. There is no doubt that sovereign immunity bars the State from pursuing the most efficient remedy, but we are not persuaded that it lacks any adequate alternatives. We have never held that individual agents or officers of a tribe are not liable for damages in actions brought by the State. See *Ex parte Young*, 209 U.S. 123, 52 L.Ed. 714, 28 S.Ct. 441 (1908). And under today's decision, States may of course collect the sales tax from cigarette wholesalers, either by seizing unstamped cigarettes off the reservation, *Colville, supra*, at 161-162, or by assessing wholesalers who supplied unstamped cigarettes to the tribal stores, *City Vending of Muskogee, Inc. v. Oklahoma Tax Comm'n*, 898 F.2d 122 (CA10 1990). States may also enter into agreements with the tribes to adopt a mutually satisfactory regime for the collection of this sort of tax.<sup>[5]</sup> See 48 Stat. 987, as amended, 25 U. S. C. § 476. And if Oklahoma and other States similarly situated find that none of these alternatives produce the revenues to which they are entitled, they may of course seek appropriate legislation from Congress.

(*Potawatomi, supra*, 498 U.S. 505, 514.)

The complexities of on-reservation enforcement actions against Indian tribes are highlighted in a 2003 Supreme Court case involving a California county and a California Indian tribe. In *Inyo County, California, et al. v. Paiut-Shoshone Indians of the Bishop Community of the Bishop Colony, et al.* (2003) 538 U.S. 701 (*Inyo*), the Supreme Court addressed a situation in which county law enforcement officers executed a state court search warrant for casino employment records kept by the tribe on its reservation. The tribe, in an effort to preclude further searches, brought suit against the county under 42 U.S.C. § 1983 (the federal civil rights statute), seeking injunctive and declaratory relief to vindicate its status as sovereign, and otherwise immune from state processes under federal law. The tribe, however, did not assert that the warrant was defective, or that the county lacked probable cause. Under these facts, the Supreme Court determined that the tribe could not sue under § 1983 to vindicate the sovereign rights it asserted.

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<sup>[5]</sup> As the state currently lacks legislative authority to enter into revenue-sharing agreements, as a result of the proposed meetings with the tribes, if appropriate, the Board may opt to support legislation that would authorize such agreements between the Board and Indian tribes. Alternatively, revenue-sharing agreements may possibly be incorporated into an Indian Gaming Compact, pursuant to the Indian Gaming Regulatory Act. (See 25 U.S.C. § 2710(d); see also *Flynt v. Cal. Gambling Control Com.* (2002) 104 Cal.App.4th 1125, 1134.)

The Supreme Court reasoned that the tribe did not qualify as a "person" under § 1983. That statute was designed to secure private rights against government encroachment, not to provide a sovereign with the means to withhold evidence relevant to a criminal investigation. Accordingly, the Supreme Court remanded the case for further proceedings to determine what federal common law, if any, would enable the tribe to maintain an action for declaratory and injunctive relief establishing its sovereign right to be free from state criminal processes. Significantly, the *Inyo* decision does not address an Indian tribe's underlying obligation to collect and remit excise tax for untaxed cigarettes or tobacco products sold on an Indian reservation to non-Indians.

Because California's potential remedies are limited under federal law, it would appear that the better approach, and the approach presently advocated by staff, would be to first seek the tribes' voluntary compliance with their collection obligations under the Cigarette and Tobacco Products Tax Law. To that end, staff intends to invite the tribes to meet and confer with staff in an effort to promote a cooperative approach to our ongoing efforts to facilitate full compliance with the Cigarette and Tobacco Products Tax Law and to continue the diligent enforcement of California's MSA-related responsibilities.

If you have any further questions, please contact Tax Counsel IV Randy Ferris at (916) 322-0437, Senior Tax Counsel Monica Brisbane at (916) 322-0438 or Senior Tax Counsel Carla Caruso at (916) 324-2816.

Approved:   
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