

UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF MICHIGAN

KEWEENAW BAY INDIAN COMMUNITY,  
a federally-recognized Indian tribe, on its own  
behalf and as *parens patriae* for its members,

Hon. Gordon J. Quist

Plaintiff,

Civil Action No. 2:05-CV-0224

v.

ROBERT J. KLEINE, Treasurer of the State of  
Michigan; JAY RISING, former Treasurer of  
the State of Michigan; MICHAEL  
REYNOLDS, Administrator of the Collection  
Division of the Michigan Department of  
Treasury; WALTER A. FRATZKE, Native  
American Affairs Specialist of the Michigan  
Department of Treasury; and TERRI LYNN  
LAND, Secretary of State of Michigan,

Defendants.

**PLAINTIFF'S MEMORANDUM IN SUPPORT OF SECOND MOTION FOR PARTIAL  
SUMMARY JUDGMENT**

**INTRODUCTION**

Plaintiff Keweenaw Bay Indian Community (the "Community") brings its second motion for summary judgment on Counts I, II, and V of the Community's Complaint.<sup>1</sup> The Community filed this lawsuit, as well as this motion and the Community's first motion for partial summary judgment, to vindicate important federal rights to immunity from state taxation for the Community's activities on its Reservation. The State violated the Community's tax immunities in 1996, and since that time, has steadfastly refused to correct this violation. At its most fundamental level, this suit addresses a critical misunderstanding by Defendants – that the State

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<sup>1</sup> All references to the "Complaint" are to the Community's Second Amended Complaint for Declaratory and Injunctive Relief.

has the right to tax the Community with respect to the Community's activities on its Reservation. Federal law makes clear that the State has no such right.

In Counts I and Count II, the Community claims that the 1993-94 sales and use taxes alleged to be owed by the Community to the State of Michigan (the "1993-94 Sales and Use Taxes") violate the Community's federal immunities from state taxation. As alleged in Count I, the 1993-94 Sales Taxes violate the Community's *categorical* federal immunity from state taxes the legal incidence of which fall on Indian tribes for their activities in Indian country. As alleged in Count II, the 1993-94 Use Taxes violate the Community's federal immunity from state taxes under the balancing test that applies to determining the validity of state taxes the legal incidence of which fall on non-Indians for activities within Indian country. The 1993-94 Use Taxes, imposed on motel and banquet room rentals, bowling shoe rentals, and telephone charges at the Community's gaming enterprise, violate the balancing test because the taxes burdened the Community's revenues derived from value generated by the Community on its Reservation. Accordingly, the 1993-94 Sales and Use Taxes, and the 1996 and 2005 Offsets relating thereto, are illegal and summary judgment should be granted to the Community on Counts I and II.<sup>2</sup>

In Count V, the Community claims that Defendants' 2005 Offsets against federal program funds earmarked for the Community and its members and other Native Americans served by the Community, which were undertaken to collect the 1993-94 Sales and Use Taxes, violate federal law for reasons independent of the legality of the 1993-94 Sales and Use Taxes. The Community is entitled to summary judgment on Count V because the 2005 Offsets against

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<sup>2</sup> If the Court grants the Community's motion based on Counts I and II, it need not reach the portion of this motion based on Count V, or the claims in the following seven additional counts of the Complaint not at issue in this motion: Counts III, IV, VII, VIII, XXVIII, XXIX, and XXX. Among other claims made in these Counts, the Community challenges *all* of the Michigan Department of Treasury offsets made in 1996 and 2005 to collect the 1993-94 Sales and Use Taxes on a variety of grounds, including infringement of the Community's rights of self-government and sovereign immunity.

federal funds violate 31 U.S.C. § 1301(a), which states that “[a]ppropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law,” and also violate the Debt Collection Improvement Act (“DCIA”), Pub. L. No. 104-134, 110 Stat. 1321, 1321-358 (Apr. 26, 1996), codified at 31 U.S.C. § 3716.

For the reasons set forth below, the Court should grant summary judgment in favor of the Community with respect to Counts I, II and V.

### **STATEMENT OF FACTS**

The Community’s claims in Counts I and II seek a determination by this Court of the legality under federal law of the Michigan Department of Treasury’s assessment and collection of \$186,277 in sales and use taxes against the Community for its 1993 and 1994 fiscal years, plus penalties and interest. These sales and use taxes are referred to herein as the “1993-94 Sales Taxes” and the “1993-94 Use Taxes.”

#### **The 1993-94 Sales and Use Tax Audits**

Beginning in 1995 and continuing through mid-1996, the Department conducted sales and use tax audits of the Community with respect to each of its fiscal years ending September 30, 1993, and September 30, 1994. See Defendants’ Second Motion for Summary Judgment Exhibits (hereinafter “Def. Ex.”) D, E, F and G. The Department issued its final reports with respect to these audits on December 18, 1996. See id.

The Department’s audit reports set forth the following proposed sales and use tax deficiencies, and reflected partial satisfaction of the proposed deficiencies through offsets made by the Department to refunds payable to the Community pursuant to the terms of its 1977 tax agreement with the State of Michigan (the “1996 Audit Offsets” or the “1996 Offsets”):

<u>Tax Types and Years</u>	<u>1993-94 Tax Deficiencies</u>	<u>1996 Audit Offsets</u>	<u>Net 1993-94 Tax Deficiencies</u>
1993 Sales Tax	\$59,498.00	\$30,394.00	\$29,104.00 <sup>3</sup>
1994 Sales Tax	\$82,587.00	\$37,856.00	\$44,731.00
1993 Use Tax	\$18,214.00	\$4,600.00 <sup>4</sup>	\$ 13,614.00
1994 Use Tax	\$25,978.00	\$14,989.00	\$10,989.00
<b><u>Totals:</u></b>	<b>\$186,277.00</b>	<b>\$87,839.00<sup>5</sup></b>	<b>\$98,438.00</b>

Defendants' Brief in Support of Second Motion for Summary Judgment ("Def. Br.") Ex. D at 9 (Sch. A, p. 1); Def. Br. Ex. E at 7 (Part IV, p. 1) ; Def. Br. Ex. F at 7 (Sch. A, p. 9); Def. Br. Ex. G at 4-5.

All of the 1993-94 Sales Taxes arose from sales made by the Community at its gaming facility and related motel, restaurant and bar, bowling, and gift shop facilities on the Reservation. Def. Br. Ex. D at 4-5; Def. Br. Ex. F at 3-4. Similarly, all of the 1993-94 Use Taxes arose from payments by the Community's customers for services provided by the Community at its gaming and related facilities on the Reservation, for motel and banquet room rentals, bowling shoe rentals, and telephone charges. Def. Br. Ex. E at 3-4, 13 (narrative & Sch. C); Def. Br. Ex. G at 3-4, 14 (narrative & Sch. C). In the case of each audit, the Department auditor concluded that

<sup>3</sup> As a result of a subtraction error, the audit report mistakenly identified this deficiency as \$29,498.00. Later communications from the Department clarify this error, and also note that *additional* offsets of \$7,433.00 were taken against a gas tax credit payable to the Community to reduce the net deficiency to \$21,671.00. See Def. Br. Ex. AA at 2.

<sup>4</sup> The audit report stated that the 1996 offset was a \$14,989.00 gasoline tax refund, but this refund appears to have been mistakenly offset by both the 1993 and the 1994 Use Tax Deficiencies. Later communications from the Department clarify this error. See Def. Br. Ex. AA at 2.

<sup>5</sup> Because of the additional offset referred to in footnote 3 above, the total 1996 Audit Offsets were \$95,272.

“[p]enalty and interest are not applicable as they are not address[ed] in the agreement.” Def. Br. Ex. D at 6; Def. Br. Ex. E at 4; Def. Br. Ex. F at 5; Def. Br. Ex. G at 4.

The audit reports each state that the audits were conducted pursuant to the terms of a 1977 tax agreement between the Community and the State of Michigan. See Def. Br. Ex. D at 5; Def. Br. Ex. E at 4; Def. Br. Ex. F at 4; Def. Br. Ex. G at 4. In November 1977, the Community had entered into an agreement with the State of Michigan (“Tax Agreement”). Affidavit of Fred Dakota (“Dakota Aff.”) at ¶ 3, Ex. A; Affidavit of Susan LaFernier (“LaFernier Aff.”) at ¶ 6. Contrary to Defendants’ claims, the audits were not and could not have been conducted pursuant to the terms of the Tax Agreement. Dakota Aff. at ¶ 8. The Tax Agreement does not authorize the Department to conduct such audits, and the Community never agreed to any sales and use tax audits. Dakota Aff. at ¶ 8 and Ex. A; Affidavit of Joseph O’Leary (“O’Leary Aff.”) at ¶ 6. Similarly, no provision of the Tax Agreement subjects the Community to liability to pay state taxes, subjects the Community to liability to collect use taxes, or waives the Community’s sovereign or federal tax immunities. Dakota Aff. at ¶ 9; O’Leary Aff. at ¶¶ 7-8. Moreover, nowhere in their own second motion for summary judgment do Defendants even attempt to argue that the 1993-94 Sales and Use Taxes were authorized by the Tax Agreement.<sup>6</sup> Because there is

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<sup>6</sup> In fact, Defendant Fratzke repeatedly admitted that the Tax Agreement does not expressly authorize the audits, assessments or offsets, and that any claimed authority for those actions must be inferred or implied. Affidavit of Skip Durocher (“Durocher Aff.”), Ex. B at 108:18-109:22 (authority for offsets “subsumed” in licensure requirements and Defendant Fratzke is “not aware of seeing anything specifically addressing it one way or another.”), 111:25-112:3 (“not aware of anything specific”), 114:7-18 (State’s right to affirmatively collect money from the Community not expressly authorized), 115:1-10 (authority is “inherent”); 128:9-24 (audits not expressly authorized by Tax Agreement, authority is derived “in general” from “State taxing authority”). In fact, as discussed in Section I below, under black letter federal law the State has no “inherent right” to tax the Community for its activities on its Reservation.

no such authority, Defendants are left instead to argue only that the Community waived its right to contest its liability for these taxes.<sup>7</sup>

The Department sent the Community bills for taxes allegedly due, reflecting proposed sales and use assessments of \$91,005.00, plus penalties and/or interest of \$138.37. Def. Br. Ex. I. As described above, the Department already had collected \$95,272 of the asserted deficiencies through the 1996 Offsets. The Community requested an informal conference in 1997. Affidavit of James Bittorf (“Bittorf Aff.”) at ¶ 6, Ex. A. The Department, however, held this conference in abeyance for approximately five years, although Mr. Fratzke was unable to explain the reason for this five year delay. Durocher Aff., Ex. B at 150:20-25 (Defendant Fratzke unable to recall the reason for the five year delay between the Community’s hearing request and the 2002 hearing).

In the Spring of 2002, the Department eventually scheduled an informal hearing on the Department’s claim that the Community had an outstanding obligation for the 1993-94 Sales and Use Taxes. Affidavit of Chad DePetro (“DePetro Aff.”) at ¶ 3. The Community’s Tribal Attorney attempted to attend this hearing by telephone, but when he contacted the Department at the time of the hearing, no one was able to locate the hearing or patch him through. Id. If he had been able to attend the hearing, he would have advised the hearing officer of the same thing that he previously advised Defendant Walter Fratzke – that the Community objected to the sales and use taxes because there was nothing in the Community’s Tax Agreement that authorized

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<sup>7</sup> The Tribal Council and the Tribal Attorneys were not even aware that the Department was conducting a sales and use tax audit in 1995 and 1996, which was a period of sustained and significant political turmoil on the Reservation. Dakota Aff. at ¶¶ 12-13; O’Leary Aff. at ¶¶ 9-11, 13, 14; Affidavit of James Bittorf at ¶ 4. The Community’s Tribal Government was literally fighting for its life during this time. O’Leary Aff. at ¶¶ 13-14.

assessment or collection of these taxes. Id.<sup>8</sup> On May 14, 2002, the Department held an informal conference regarding the 1993-94 Sales and Use Taxes. In an undated document, the Department Referee issued an Informal Conference Recommendation (the “Recommendation”) upholding the 1993-94 Sales and Use Taxes. Def. Br. Ex. AA. On September 20, 2002, the Department issued its Decision and Order of Determination (the “Decision”) in accordance with Referee Meyer’s Recommendation. Def. Ex. BB. The Decision and the Recommendation each stated that neither penalties nor interest shall be applied. Def. Ex. AA at 5; Def. Ex. BB at 2.

### **The 2002 Offsets**

On September 27, 2002, following the issuance of the Decision, the Department issued Final Bills For Taxes Due (“Final Assessments”) to the Community with respect to the 1993-94 Sales and Use Taxes, in the following amounts; these amounts included interest, which directly conflicts with the Department’s own Decision:

<b><u>Tax Type and Year</u></b>	<b><u>Tax Liability</u></b>	<b><u>Interest</u></b>	<b><u>Total</u></b>
1993 Sales Tax	\$21,671.00	\$11,302.71	\$32,973.71
1994 Sales Tax	\$44,731.00	\$23,330.01	\$68,061.01
1993 Use Tax	\$13,614.00	\$ 7,100.47	\$20,714.47
1994 Use Tax	\$10,989.00	\$ 5,731.33	\$16,720.33
<b><u>Totals:</u></b>	<b>\$91,006.00</b>	<b>\$47,464.51</b>	<b>\$138,469.52</b>

Def. Br. Ex. DD.

<sup>8</sup> While the Community was willing to consider resolution of the Department’s claim in the context of entering into a new tax agreement, it never agreed that the Department was entitled to assess or collect these taxes. DePetro Aff. at ¶ 3.

Since September 27, 2002, the Department has sent to the Community a Monthly Statement of Account purporting to summarize the balances owed by the Community to the Department with respect to 1993-94 Sales and Use Taxes. Durocher Aff. at ¶ 2; Def. Br. Ex. HH. These Monthly Statements of Account show that penalties and interest have accrued on these balances, contrary to the Department's decision. Def. Br. Ex. HH.

In November 2002, Defendants or their predecessors offset against federal and state funds owed to the Community to satisfy, in whole or in part, the Final Assessments. DePetro Aff. at ¶ 4; Durocher Aff. at ¶ 23, Ex. J at 855-60; Ex. C at 86:5-11, 102:1-5. These offsets occurred without warning or opportunity to contest the offsets. Durocher Aff., Ex. C at 34:6-35:7. Shortly after the Community learned of these offsets, its Tribal Attorney Chad DePetro contacted the Department to object to the offsets as illegal and improper, and demanded that they be reversed. DePetro Aff. at ¶ 4; Durocher Aff., Ex. B at 175:5-176:25. The Department, through the actions of Defendants Reynolds and Fratzke, eventually placed the Community's account on manual "bypass" status, which was supposed to prevent additional offsets. Durocher Aff., Ex. C at 83:16-84:3 (account placed on bypass status by Defendant Reynolds; Defendant Reynolds has the capacity/authority to place taxpayer accounts on bypass status), 86:17-21 (Defendant Fratzke instructed Defendant Reynolds to put the Community's account on bypass status). Defendant Reynolds directed that the 2002 Offsets be reversed, resulting in the offset funds being returned to the Community. Durocher Aff. at ¶ 23, Ex. J at 859; Durocher Aff., Ex. C at 89:1-92:-24; DePetro Aff. at ¶ 4; LaFernier Aff. at ¶ 12.

### **The 2005 Offsets**

In May and June 2005, Defendants once again offset against federal funds belonging to the Community and its members to be offset to satisfy, in whole or in part, the Final

Assessments. The 2005 Offsets were made with respect to the following fund categories on the following approximate dates in the following approximate amounts:

<b><u>Fund Category</u></b>	<b><u>Approximate Offset Date(s) in 2005</u></b>	<b><u>Offset Amount</u></b>
Federal Medicaid Program	May 10, 17, 25, and 31; June 7	\$ 4,157.61
Federal Women, Infant & Children Program	June 7	\$28,670.42
Federal Safe and Stable Families Program	May 25	\$ 410.00
Federal Child Day Care Program	May 10; June 7	\$ 928.28
State Motor Fuel Tax Refunds	June 1 and 2	\$ 9,720.04
State Prepaid Sales Tax Refunds	June 8	\$45,903.44
Unknown at present	June 14	\$13,715.11
<b><u>Total:</u></b>		<b>\$103,504.90<sup>9</sup></b>

Defendants' Answer at ¶ 42; Durocher Aff. at ¶ 30, Ex. Q (excerpt from Defendants' Responses to Plaintiff's First Set of Requests for Admissions). Like the 2002 Offsets, the 2005 Offsets occurred without warning or opportunity to contest the offsets. Durocher Aff., Ex. C at 34:6-35:7.

In correspondence to the Department, the Community raised similar objections to the 2005 Offsets as it raised to the 2002 Offsets, and requested that the Department reverse the offsets as it did in 2002. Durocher Aff. at ¶ 24, Ex. K; ¶ 25, Ex. L. Defendant Fratzke responded that the Department made the 2005 Offsets in reliance on "the common law right of the State to set off any liquidated sums which may be due it by a citizen against any refund or

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<sup>9</sup> It is apparent from comparing this total with the amount of the tax reflected in the Final Assessments that the Department collected at least \$12,498.90 in interest and/or penalties from the Community. See Def. Br. Ex. DD.

income tax which may be due the citizen.” Durocher Aff. at ¶ 26, Ex. M. Defendant Fratzke further stated on June 28, 2005, that the Department would further evaluate the situation upon receiving the Community’s reasoning and support for its position, and would refund any of the 2005 Offsets where warranted. *Id.* The Community provided such reasoning and support on August 9, 2005. Durocher Aff. at ¶ 27, Ex. N. The Department, however, failed to reverse any of the 2005 Offsets. Durocher Aff., Ex. B at 156:16-23 (Defendant Fratzke did not take any action to reverse 2005 Offsets), 177:25-178:6 (Defendant Fratzke had notice that 2005 Offsets involved federal funds), 192:17-19 (same); Ex. C at 137:16-138:5 (Defendant Reynolds unable to recall due to unavailability of history text in missing MARCS documents at deposition, but acknowledging that the 2005 Offsets have not been reversed).

**SUMMARY JUDGMENT STANDARD UNDER FED. R. CIV. P. 56**

Summary judgment is appropriate where “the pleadings, the discovery and disclosure materials on file, and any affidavits, if any, show that there is no genuine issue as to any material fact and that the movant is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c). In deciding a motion for summary judgment, the court views the factual evidence and draws all reasonable inferences in favor of the non-moving party. *See National Enters., Inc. v. Smith*, 114 F.3d 561, 563 (6th Cir. 1997). To prevail, the non-movant must show sufficient evidence to create a genuine issue of material fact. *See Klepper v. First Am. Bank*, 916 F.2d 337, 341-42 (6th Cir. 1990) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986)). A mere scintilla of evidence is insufficient; “there must be evidence on which the jury could reasonably find for the [non-movant].” *Id.* at 342 (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986)).

## ARGUMENT

**I. BOTH THE 1993-94 SALES TAXES AND THE 1993-94 USE TAXES WERE INVALID AS A MATTER OF FEDERAL LAW AND, THUS, THE 1996 OFFSETS AND 2005 OFFSETS UNDERTAKEN TO COLLECT THESE INVALID TAXES, A FORTIORARI, WERE INVALID UNDER FEDERAL LAW.**

Both the 1993-94 Sales Taxes and the 1993-94 Use Taxes violated long-standing federal common law rules precluding the application of state taxes within Indian country. Because the 1993-94 Sales and Use Taxes were illegal, the 1996 Offsets and 2005 Offsets undertaken to collect such improper taxes necessarily violated federal law as well.

**A. The 1993-94 Sales Taxes Violated the Categorical Bar on State Taxation of Indian Tribes for Sales Made Within Indian Country.**

The 1993-94 *Sales Taxes* clearly violated federal law. It is well settled that states are “categorically barred” by federal law “from placing the legal incidence of an excise tax *on a tribe or on tribal members* for sales made *inside Indian country* without congressional authorization.” Wagon v. Prairie Band Potawatomi Nation, 546 U.S. 95, 101-02 (2005) (emphasis in original) (internal quotation marks omitted); see also Oklahoma Tax Comm’n v. Chickasaw Nation, 515 U.S. 450, 458 (1995); Durocher Aff. ¶ 31, Ex. R (Michigan Department of Treasury memorandum dated August 10, 1977, acknowledging the “[b]asic principl[e]” that “States can’t tax reservation Indians when legal incidence of tax falls on the reservation Indian, as to activities or property located entirely within an Indian reservation”). It is also well settled that the legal incidence of the Michigan sales tax falls directly upon the *retailer*, who pays the sales tax for the privilege of engaging in the retail sale of tangible personal property. See, e.g., Op. Mich. Att’y Gen. 7062 (Oct. 4, 2000); Sims v. Firestone Tire & Rubber Co., 245 N.W.2d 13, 14-15 (Mich.1976); Fed. Reserve Bank of Chicago v. Dep’t of Revenue, 64 N.W.2d 639, 643 (Mich. 1954); Nat’l Bank of Detroit v. Dep’t of Revenue, 54 N.W.2d 278, 281 (Mich.1952).

Liability for the sales tax is triggered in any given instance when the retailer makes a “sale at retail” that is not otherwise exempt under the statute. Mich. Comp. Laws §§ 205.51(1)(b), 205.52(1). Because the 1993-94 Sales Taxes involved sales by the Community as a retailer within its Reservation, Michigan was “categorically barred” from imposing its sales tax upon such sales.<sup>10</sup> Accordingly, the 1993-94 Sales Taxes, purportedly imposed upon transactions where the Community bore the legal incidence of the sales tax, were invalid as a matter of federal law.

**B. The 1993-94 Use Taxes Violated Federal Law Because the Taxes Burdened the Community’s Revenues Derived from Value Generated by the Community on its Reservation.**

Like the 1993-94 Sales Taxes, the 1993-94 *Use Taxes* also violated federal law. The legal incidence of the Michigan use tax clearly falls on the user of tangible personal property or services subject to the tax, Mich. Comp. Laws § 205.93(1), and the users with respect to the 1993-94 Use Taxes were non-Indians who made purchases from the Community. See Def. Exs. E, G. Where the legal incidence of a state excise tax falls on non-Indians for transactions involving reservation Indians, the tax is preempted if the federal and tribal interests against state taxation outweigh the state’s interest in imposing the tax. E.g., Chickasaw Nation, 515 U.S. at 459; Ramah Navajo School Bd. v. Bureau of Revenue of New Mexico, 458 U.S. 832, 838 (1982); White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 144-45 (1980); Prairie Band of Potawatomi Indians v. Pierce, 253 F.3d 1234, 1253 (10th Cir. 2001); Indian Country, U.S.A., Inc. v. Oklahoma Tax Comm’n, 829 F.2d 967, 981-82 (10th Cir. 1987), cert. denied, 487 U.S. 1218 (1988). In applying the balancing test, the federal courts give heavy weight to the tribe’s

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<sup>10</sup> The Community’s Reservation, as well as land held in trust for the Community outside the Reservation, constitutes “Indian country” for federal tax immunity purposes. 18 U.S.C. § 1151 (defining “Indian country” to include “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.”).

interest when the revenues burdened by the tax are derived from value “generated on the reservations by activities in which [Indians] have a significant interest.” Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 155 (1980); accord Sac & Fox Nation of Missouri v. Pierce, 213 F.3d 566, 585 (10th Cir. 2000), cert. denied, 531 U.S. 1144 (2001); Indian Country, U.S.A., 829 F.2d at 986. Accordingly, the courts have repeatedly enjoined state taxes imposed on purchases by non-Indians at reservation entertainment centers owned and managed by Indian tribes. In Indian Country, U.S.A., for instance, the Tenth Circuit held that a tribal bingo enterprise embodied sufficient reservation value to preclude the imposition of a state tax on non-Indians because (1) the enterprise was located on Creek Nation lands, (2) the Creek Nation owned and controlled the enterprise, and (3) Creek Nation members predominated as employees of the enterprise. 829 F.2d at 982-83, 986. Similarly, in Prairie Band Potawatomi Nation v. Richards, 379 F.3d 979, 986-87 (10th Cir. 2004), rev’d on other grounds, 546 U.S. 95 (2005), the Tenth Circuit struck down imposition of a state fuel tax upon a tribe’s fuel sales to non-Indians because of the reservation value embodied in the tribe’s on-reservation gaming enterprise, of which the tribe’s fuel station formed an integral part. The Ninth Circuit took a similar approach in Gila River Indian Cmty. v. Waddell, 967 F.2d 1404 (9th Cir. 1992), where it emphasized the reservation value in the tribe’s comprehensive entertainment enterprise – including a marina, an auto racetrack, an amphitheater, and associated concession buildings – in holding that the tribe’s alleged control and regulation of the entertainment events gave it “a strong interest in maintaining those activities free from state interference.” 967 F.2d at 1410.<sup>11</sup> These cases follow the reasoning of the Supreme Court in California v. Cabazon Band

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<sup>11</sup> In a later decision in the same case, the Ninth Circuit upheld the district court’s grant of summary judgment against the Tribe, primarily on the ground that the Tribe’s claim of active involvement in the entertainment activities was “unsupported by the record.” Gila River Indian Community v. Waddell, 91 F.3d 1232, 1238 (9th Cir. 1996).

of Mission Indians, 480 U.S. 202 (1987), where the Court struck down an attempt to apply state and local gambling regulations within two Indian reservations. In precluding the state and local regulations, the Cabazon Court emphasized that the tribes:

have built modern facilities which provide recreational opportunities and ancillary services to their patrons, who do not simply drive onto the reservations, make purchases and depart, but spend extended periods of time there enjoying the services the Tribes provide. The Tribes have a strong incentive to provide comfortable, clean, and attractive facilities and well-run games in order to increase attendance at the games. . . . the Cabazon and Morongo Bands are generating value on the reservations through activities in which they have a substantial interest.

*Id.* at 219-20.

Here, application of the facts to the federal balancing test results in preemption of the 1993-94 Use Tax. Each of the transactions to which the 1993-94 Use Taxes relate involved purchases of products and services by non-Indians at reservation entertainment centers owned and operated by the Community. The purchases consisted of motel and banquet room rentals, bowling shoe rentals, and telephone charges at the Community's gaming and related facilities on the Reservation. Because the Community built, managed, and provided "recreational opportunities and ancillary services" at these entertainment facilities, the products and services purchased and consumed at the facilities were clearly "generated on the reservatio[n] by activities in which [Indians] have a significant interest." The Community's interest in precluding the imposition of the use tax upon products and services imbued with reservation value outweighs Michigan's generalized interest in raising revenue. Accordingly, the 1993-94 Use Taxes were clearly preempted by federal law.

**C. Defendants Cannot Avoid The Community's Federal Tax Immunities Based Upon Their Procedural Arguments.**

Defendants in their motion for summary judgment do not even attempt to argue that the 1993-94 Sales and Use Taxes were authorized under the 1977 Tax Agreement or were otherwise consistent with federal law.<sup>12</sup> Rather, Defendants' motion avoids this issue entirely by seeking to dismiss the Community's claims on jurisdictional grounds or on grounds of waiver.

Defendants' procedural arguments have no merit. See Plaintiff's Mem. in Opposition to Def. Br. at Sections I-III.

**D. The 1996 Offsets and the 2005 Offsets Likewise Were Invalid as a Matter of Federal Law.**

Because federal law plainly precludes both the 1993-94 Sales Taxes and the 1993-94 Use Taxes, the 1996 Offsets and the 2005 Offsets undertaken to collect these improper taxes lacked any legal basis and were invalid under federal law. The 1993-94 Sales and Use Taxes form the alleged liability for the 1996 and 2005 Offsets; if there is no liability, there can be no offsets based on that liability. Accordingly, the Court should order summary judgment for the Community on Counts I and II of its Complaint.

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<sup>12</sup> Defendants suggest in their "Facts" section that the Tax Agreement "was clear in its default provision that issues not addressed specifically were to be resolved by Michigan law," Defs.Br. at 2, because the Tax Agreement contained a provision requiring the Community's K-BIT-C store to obtain a Michigan retail sales tax license. To the contrary, if the Tax Agreement were clear, then presumably Defendants' motion would rest on the terms of the Tax Agreement rather than on their jurisdictional and waiver arguments. The Tax Agreement says *absolutely nothing* about the Community's responsibilities for paying or collecting Michigan sales or use tax *as a retailer*, much less purport to describe such responsibilities in an exhaustive fashion. Defendants should well know that the "default provision" in Indian country, since at least the 1830s, has been that state law does *not* apply to reservation Indians for their activities in Indian country, unless Congress legislates clearly and expressly to the contrary. Nevada v. Hicks, 533 U.S. 353, 362 (2001), citing Worcester v. Georgia, 31 U.S. 515 (1832); Cabazon, 480 U.S. at 214. The Tax Agreement's silence regarding the general application of Michigan law is in stark contrast with Michigan's current Tribal/State Tax Agreement, which contains an express waiver of tribal sovereign immunity for specified purposes and refers to the applicability of "State law" no fewer than approximately 70 times. See, e.g., Tax Agreement Between the Bay Mills Indian Community and the State of Michigan (Dec. 20, 2002) [http://www.michigan.gov/documents/BayMillsFinalTaxAgreement\\_61196\\_7.pdf](http://www.michigan.gov/documents/BayMillsFinalTaxAgreement_61196_7.pdf).

**II. THE 2005 OFFSETS OF THE COMMUNITY'S FEDERAL PROGRAM FUNDS VIOLATED FEDERAL LAWS FORBIDDING STATE OFFSETS OF THOSE FUNDS.**

The 2005 Offsets of the Community's federal program funds were improper and illegal for the additional reason that they violated federal laws forbidding state offsets of those funds for improper uses.

**A. The 2005 Offsets of Federal Program Funds Violated Federal Law Because Funds Earmarked by Congress for a Specific Purpose Must Be Used for That Purpose.**

The 2005 Offsets against the Community's federal funds violate 31 U.S.C. § 1301(a), which states that “[a]ppropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law.” This long-standing legal principle is rooted in the United States Constitution's Appropriations Clause, which states that “no money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law.” U.S. Const., art. I, § 9, cl. 7. It is well-settled that “specific appropriations, if not used for the particular work designated by Congress, can not be used for any other purpose.” 21 Op. Att'y. Gen. 414, 415 (1896).

The federal funds that were the subject of offset by the Defendants to pay state taxes allegedly owed by the Community were indisputably earmarked for the Community for use in accordance with the terms four federal programs, the federal Medicaid program, the Special Supplemental Nutrition Program for Women, Infants, and Children (“WIC”), the Child Care program and the Promoting Safe and Stable Families Program. LaFernier Aff. at ¶ 11. The Community was required under federal law to use the federal funds to administer tribal government programs and to provide direct benefits to Community members and other Native Americans in the Community's service area. *Id.* The beneficiaries of these programs were the

Community, its members, and other Native Americans in the Community's service area, *not* the Michigan Department of Treasury. *Id.*

**B. The 2005 Offsets Also Violated the Debt Collection Improvement Act of 1996 Because the Federal Government Could Not Have Offset the Community's Medicaid, WIC, Child Care, and Safe & Stable Families Program Funds, and States are Likewise Prohibited.**

Defendants' 2005 Offsets against the Community's federal funds also violate federal law because the federal government itself is precluded from such offsets pursuant to the Debt Collection Improvement Act of 1996.

**1. The Debt Collection Improvement Act of 1996.**

Congress enacted the Debt Collection Improvement Act ("DCIA"), Pub. L. No. 104-134, 110 Stat. 1321, 1321-358 (Apr. 26, 1996), codified at 31 U.S.C. § 3716, to authorize the United States Department of Treasury to offset federal payments for the purpose of collecting delinquent debts owed to the United State or to States. *See* 31 U.S.C. § 3701(b)(2) (definition of "claim" and "debt" include amounts owed to States). The DCIA authorizes an "administrative offset," defined as "withholding funds payable by the United States (including funds payable by the United States on behalf of a State government) to, or held by the United States for, a person to satisfy a claim." 31 U.S.C. § 3701(a)(1). As a threshold matter, under Section § 3716(h)(1) of the DCIA, administrative offset only applies "to any past-due, legally-enforceable debt owed to a State."

The federal statutory procedure for offsetting against federal funds occurs through a process called "centralized administrative offset" administered through the United States Department of Treasury's Financial Management Service's Treasury Offset Program ("U.S. Treasury Offset Program"). *See* U.S. Department of the Treasury, Financial Management Service, Debt Management Services, "Exemption of Classes of Federal Payments from the

Treasury Offset Program Standards and Procedures” (January 4, 2001) available at <http://fms.treas.gov/debt/dmexem.pdf> (hereinafter “U.S. Treasury Offset Program Exemption Standards and Procedures”). See Durocher Aff. at ¶ 29, Ex. P. The DCIA provides specific procedural safeguards for administrative offset, authorizing the heads of executive, judicial and legislative agencies to collect a debt by administrative offset only after giving the debtor written notice, an explanation of the debtor’s rights, an opportunity to inspect the records of the agency related to the claim, an opportunity for review within the agency, and an opportunity to make a written agreement for the repayment of the debt. 31 U.S.C. § 3716(a)(1)-(4).

The DCIA exempts certain classes of federal funds from the Treasury Offset Program either (1) because the funds are statutorily exempt from offset, or (2) by action of the Secretary of the Treasury at the request of the head of a federal agency. U.S. Treasury Offset Program Exemption Standards and Procedures, at 1; 31 U.S.C. § 3716.

**2. The 2005 Offsets of Federal Funds Categorically Violated the DCIA Because the 1993-94 Sales and Use Taxes Were Not a “Past-Due, Legally Enforceable Debt Owed to a State.”**

The Defendants categorically violated the DCIA because, as explained above, supra at 16-17, the 1993-94 Sales and Use Taxes were not a legally enforceable debt owed by the Community to the State of Michigan under the federal law that governs this matter. Thus, the 2005 Offsets of federal funds were illegal under Section 3716(h)(1) of the DCIA.

**3. All of the Federal Fund Categories at Issue Are Exempt from Administrative Offset.**

All payments made under the Social Security Act are statutorily exempt from administrative offset. See U.S. Department of the Treasury, Financial Management Service, Debt Management Services, “Treasury Offset Program Payments Exempt From Offset By Disbursing Officials,” (June 2006) available at <http://fms.treas.gov/debt/dmexmpt.pdf>

(hereinafter “U.S. Treasury Offset Program Exemptions”); Durocher Aff. at ¶ 29, Ex. P; 31 U.S.C. § 3701(d). Medicaid, Child Care, and Promoting Safe and Stable Families payments are all made pursuant to the Social Security Act, and are all therefore exempt from administrative offset. See Social Security Act, 42 U.S.C. Ch. 7 (Disp Table); Medicaid Act, codified at 42 U.S.C. § 1396 et seq.; Child Care, codified at 42 U.S.C. § 618 et seq.; Promoting Safe and Stable Families Program, codified at 42 U.S.C. § 629 et seq.

In addition to federal funds exempt from offset by statute, the DCIA provides that the Secretary of the Treasury may exempt program funds from the U.S. Treasury Offset Program at the request of the head of the federal agency responsible for the program. See 31 U.S.C. § 3716(c)(3)(B). WIC payments are exempt from administrative offset by action of the Secretary. U.S. Treasury Offset Program Exemptions at 2.

Accordingly, *every category of federal funds* at issue in the disputed 2005 Offsets is prohibited from administrative offset by the federal government under the DCIA. It is axiomatic under the Supremacy Clause of the U.S. Constitution that state governments are also forbidden to offset these exempt federal program funds.

**CONCLUSION**

For the foregoing reasons, the Community respectfully requests that this Court grant the Community's motion for partial summary judgment on Counts I, II, V, and XXIX of the Complaint and order the following relief:

1. Enter judgment in favor of the Community declaring that the 1993-94 Sales and Use Taxes, the 1996 Offsets, and the 2005 Offsets are invalid;
2. Order Defendants to reverse the 1996 Audit Offsets and the 2005 Offsets and restore to the Community the funds improperly withheld as a result of the offsets;
3. Enjoin Defendants from taking any further actions to collect the 1993-94 Sales and Use Taxes, through offsets or otherwise; and
3. Award the Community such other relief as the Court deems just and appropriate.

Dated: December 14, 2007

Respectfully submitted,

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