

addressed this issue: in Lac du Flambeau Band of Lake Superior Chippewa v. Zeuske, 145 F.Supp.2d 969 (W.D. Wis. 2000), the U.S. District Court for the Western District of Wisconsin held that the State of Wisconsin had no authority to tax the out-of-state income of a Band member residing on the Reservation.¹ The facts in the present case are substantially similar to those in Zeuske.

II. FACTS

The Fond du Lac Band is a federally recognized Indian tribe and occupies the Fond du Lac Reservation pursuant to the Treaty of LaPointe with the United States of September 30, 1854, which “set apart” the Reservation for the exclusive occupation and use of the Band. 10 Stat. 1109, Art. 2 (Exhibit A).² The Band has approximately 3800 members. The Band is governed by its tribal council, the Reservation Business Committee, which exercises authority over its members and territory pursuant to the Band’s residual aboriginal sovereignty. The Band performs a wide variety of governmental functions and exercises broad civil regulatory authority on the Reservation.

¹ In Zeuske, that Court held that the State of Wisconsin had no authority to tax the income of a member of the Lac du Flambeau Band of Lake Superior Chippewa who resided on the Lac du Flambeau Reservation where the income was earned outside of the State as a truck driver for a company operating out of Minnesota. Id., 145 F.Supp. 2d at 971-72. The State of Wisconsin did not appeal the decision, but immediately modified its collection practices to accommodate tribal immunity in these circumstances. Discussed further at Argument III.D., below.

² The Fond du Lac Reservation constitutes “Indian Country” within the meaning of federal law. 18 U.S.C. § 1151; and, e.g., Alaska v. Native Village of Venetie, 522 U.S. 520 (1998) (Indian country definition at 18 U.S.C. § 1151 applies in civil matters).

Leonard M. Houle (“Mr. Houle”) is an enrolled member of the Fond du Lac Band. See Affidavit of Fond du Lac Enrollment Clerk Linda J. Nelson at Exhibit B. The Minnesota Department of Revenue has executed at least two levies on the personal bank account of Mr. Houle in order to collect income taxes allegedly owed for past tax years. Mr. Houle was born at the Indian Hospital on the Reservation in 1929, and is a lifelong domiciliary of the Reservation. During the relevant tax years, Mr. Houle maintained his permanent home on the Reservation at 1785 White Spruce Drive, Cloquet, Minnesota. Mr. Houle served in the United States Army from 1948-1968, and is a Korean War veteran. At no time during his term of service with the Army was Mr. Houle stationed within Minnesota.³ The income which is being taxed by the State is derived from the pension that he receives from the U.S. Defense Finance and Accounting Service. See Affidavit of Leonard M. Houle and incorporated exhibits at

³ State taxation of Mr. Houle’s military earnings would also be subject to limitation under the Soldiers’ and Sailors’ Civil Relief Act (SSCRA), 50 U.S.C. App. § 574, which provides that service members do not lose their domicile for the state income tax purposes when they are absent from that domicile performing military service, and that income earned by servicemen in a state of which the serviceman is not a domiciliary shall not be deemed to be earned in that state. The SSCRA broadly defines both the term ‘taxation’ and the class of ‘personal property’ exempted from state taxation. Id.; see also Dameron v. Broadhead, 345 U.S. 322, 325 (1953)(the SSCRA requires that “the taxable domicile of servicemen shall not be changed by military assignments”); and Fatt v. Utah State Tax Comm’n, 884 P.2d 1233, 1234-35 (Utah 1994)(Navajo serviceman retained reservation domicile in Utah portion of the Navajo reservation and was not subject to Utah taxation of income earned at military base in California). The U.S. Department of Justice has issued a memorandum which concludes that the SSCRA, as “construed in light of general principles of federal Indian law, prohibits States from taxing the military compensation of Native American service members who are residents or domiciliaries of tribal reservations, and who are absent from those reservations by virtue of their military service.” U.S. Dept. of Justice, Office of Legal Counsel, “Withholding State Income Tax from the Military Compensation of Native American Service Members Who Claim Residence or Domicile on a Federally Recognized Tribal Reservation” November 22, 2000 (Exhibit C).

Exhibit D. There are numerous other similarly situated Band members who reside within the Reservation and derive income from a variety of out-of-state sources: e.g. federal benefits, private pensions, investment income, and employment.

The Band has attempted to persuade the Department of Revenue of the correctness of the Zeuske decision for several years. After the execution of the first levy by the Department on Mr. Houle's military pension in September 2008, Band Chairwoman Karen R. Diver sent a letter to Minnesota Governor Tim Pawlenty regarding the taxability of income derived by resident tribal members from out-of-state sources. See letter October 20, 2008 at Exhibit E. The Chairwoman received a reply letter from Defendant, Minnesota Revenue Commissioner Ward Einess dated December 11, 2008 which indicated that the State narrowly reads federal law as only providing for state income tax exemptions for "income wholly derived from reservation sources" (citing McClanahan v. Arizona Tax Comm'n, 411 U.S. 164 (1973)), rejects the "correctness" of the Zeuske decision, and cites inapposite Supreme Court decisions which upheld the right of states to tax tribal tobacco sales to nonmembers. Id., at Exhibit F. The Band filed its Complaint on February 29, 2009.

The Band contends that the State's imposition of its income tax on a tribal member for income derived from outside the boundaries of the State, based on the member's residence on the Reservation, is barred by federal common law limiting the authority of states within Indian country, and by the requirements arising from due process and commerce clauses of the United States Constitution that there be a nexus between the State and the party sought to be taxed. See Complaint, ¶ 10.

In its Answer, the State asserts that “state taxation of the out-of-state income earned by Band members who live on the Reservation is based on the Band member’s residency in the State of Minnesota”, *id.*, ¶ (1)(II)(a), and denies that federal law limits its ability to do so. *Id.*, ¶¶ 1(b); 1(I)(c); and 4. In short, the State’s position appears to be that it will continue the practice until there is specific, binding court precedent to the contrary. A definite and concrete controversy exists between the parties, *e.g.*, Nat’l Fed’n of the Blind of Mo. v. Cross, 184 F.3d 973, 979 (8th Cir. 1999), and a “suit by an Indian tribe to enjoin the enforcement of state tax laws is cognizable in [federal] district court.” Montana v. Blackfeet Tribe, 471 U.S. 759, 761 n. 2 (1985); accord Oklahoma Tax Comm’n v. Citizen Band Potawatomi Indian Tribe, 498 U.S. 505, 507 (1991); and Moe v. Salish & Kootenai Tribes, 425 U.S. 463, 473 (1976)(tribes can challenge validity of state taxation under 28 U.S.C. § 1362 despite Anti-Injunction Act, 28 U.S.C. § 1341).

III. ARGUMENTS

This matter presents a pure question of law, and the legal issue before the Court is narrow: **Does the State of Minnesota have authority under federal law to tax income, earned outside the State, of a tribal member who resides on his tribe’s reservation where the sole basis for such taxation is the tribal member’s alleged status as a Minnesota resident?** The issue is resolved in favor of the Band by reference to the fundamental due process limitations of the state’s taxing authority against the “backdrop” of tribal sovereignty, McClanahan v. Arizona Tax Comm’n, 411 U.S. 164, 172 (1973), and well-established principles of federal Indian law. As recognized in Zeuske, an analysis of the applicable legal

principles demonstrates that a tribal member's domicile on the reservation cannot serve as the basis for the imposition of the Minnesota income tax.

A. State Taxation of the Out-of-State Income of Tribal Members Who Are Domiciled on Their Reservation is Barred by Controlling Indian Taxation Principles

The regulation of Indian affairs is reserved to Congress under the Indian Commerce Clause of the U.S. Constitution, Art. I, § 8, cl. 3. Federal common law accordingly regards state regulation or taxation of tribes and individual Indians on their reservation as an infringement of the tribal right of self-government: “[A]bsent governing acts of Congress, the question has always been whether the state action infringed on the right of reservation Indians to make their own laws and be ruled by them.” Williams v. Lee, 358 U.S. 217, 220 (1959); see also California v. Cabazon Band of Mission Indians, 480 U.S. 202, 207 (1987).

The U.S. Supreme Court has consistently held that states can only tax reservation Indians where Congress has expressly consented to the application of such state taxation. See, e.g., Oklahoma Tax Comm’n v. Chickasaw Nation, 515 U.S. 450, 455-56 (1995) (“[A]bsent cession of jurisdiction or other federal statutes permitting it, we have held, a State is without power to tax reservation lands and reservation Indians.”) (quoting Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148 (1973)); County of Yakima v. Confederated Tribes and Bands of Yakima Nation, 502 U.S. 251, 258 (1992) (same); Cabazon, supra, 480 U.S. at 215 n. 17 (1987) (“In the special area of state taxation of Indian tribes and individual Indians, we have adopted a per se rule” requiring explicit congressional authorization); Blackfoot Tribe, supra, 471 U.S. at 764, 766 (“In keeping with its plenary authority over Indian affairs, Congress can authorize the imposition of

state taxes on Indian tribes and individual Indians ... It has not done so often, and the Court consistently held that it will find the Indians' exemption from state taxes only lifted when Congress has made its intention to do so unmistakably clear ... States may tax Indians only when Congress has manifested clearly its consent to such taxation.”); Bryan v. Itasca County, 426 U.S. 373, 393 (1976)(“Indians stand in a special relation to the federal government from which the states are excluded unless the Congress has manifested a clear purpose to terminate [a tax] immunity and allow states to treat Indians as part of the general community.”)(quoting Oklahoma Tax Comm’n v. United States, 319 U.S. 598, 613-14 (1943)(Murphy, J., dissenting)). and McClanahan v. Arizona Tax Comm’n, 411 U.S. 164, 181 (1973)(“appellant’s rights as a reservation Indian were violated when the state collected a tax from her which it had no jurisdiction to impose”).

This overwhelming body of precedent creates a presumption against state taxing power within Indian country. See, e.g., Oklahoma Tax Comm’n v. Sac and Fox Nation, 508 U.S. 114, 128 (1993)(“Absent explicit congressional direction to the contrary, we presume against a State’s having the jurisdiction to tax within Indian country”) In Chickasaw Nation, the Supreme Court rejected any “balancing test” approach to state taxation of reservation Indians, and declared the requirement of federal statutory authorization to be categorical:

When a State attempts to levy a tax directly on an Indian tribe or its members inside Indian country . . . we have employed, instead of a balancing inquiry, “a more categorized approach: ‘[A]bsent cession of jurisdiction or other federal statutes permitting it,’ we have held a State is without power to tax reservation lands and reservation Indians ... Taking this categorical approach, we have held unenforceable a number of state taxes whose legal incidence rested on a tribe or tribal members inside Indian country.

Id., 515 U.S. at 458 (quoting County of Yakima, supra, and citing Bryan v. Itasca County, 426 U.S. 373 (1976); and McClanahan, supra, 411 U.S. at 165-66)(emphasis added). As acknowledged in the State’s Answer, these decisions “speak for themselves”. Id., ¶¶ 1(I)(d); 1(II)(d); 1(III)(b); and 4(a).

The absence of state authority in this matter is underscored by the canons of construction applicable to Indian affairs, which requires that “statutes are to be construed liberally in favor of the Indians, with ambiguous provisions interpreted to their benefit.” Blackfeet Tribe, supra, 471 U.S. at 766; see also Minnesota v. Mille Lacs Band of Chippewa, 526 U.S. 172, 202 (1999); County of Yakima, supra, 502 U.S. at 269; and Washington v. Washington State Commercial Passenger Fishing Vessel Assn., 443 U.S. 658, 675-76 (1979). The Indian law canons supersede the usual principles of tax law. Indeed, “although tax exemptions generally are to be construed narrowly, in ‘the government’s dealing with Indians, the rule is exactly the contrary. The construction, instead of being strict, is liberal.’” Blackfeet Tribe, supra, 471 U.S. at 766 n. 4 (quoting Choate v. Trapp, 224 U.S. 665, 675 (1912)).

The above precedents make clear that a state’s authority to impose taxes on tribal members within reservation boundaries requires clear congressional authorization. The State bears the burden of overcoming the strong presumption against taxation by demonstrating that Congress has authorized the tax sought to be imposed here. The State has not, and cannot, meet this burden. On the contrary, **the State has cited no evidence of congressional authorization to impose its income tax on the out-of-state income of resident tribal members.**

In McClanahan v. Arizona Tax Comm'n, 411 U.S. 164 (1973), the Supreme Court held that the State of Arizona lacked jurisdiction to tax a reservation Indian for income earned on his tribe's reservation. In doing so, the Court necessarily rejected the State's argument that domicile on the reservation was a sufficient basis for taxation where the reservation otherwise lies within the boundaries of the State. The parameters established by McClanahan control this case:

'[T]he policy of leaving Indians free from state jurisdiction and control is deeply rooted in the Nation's history.' This policy was first articulated by this Court 141 years ago [and] held that Indian nations were 'distinct political communities' having territorial boundaries, within which their authority is exclusive, and having a right to all the lands within those boundaries, which is not only acknowledged, but guaranteed by the United States ...

McClanahan, 411 U.S. at 168 (quoting Rice v. Olson, 324 U.S. 786, 789 (1945) and Worcester v. Georgia, 32 U.S. (6 Pet.) 515, 557 (1832)).

It must always be remembered that the various Indian tribes were once independent and sovereign nations, and that their claim to sovereignty long predates that of our own Government ...

Finally, we cannot accept the notion that it is irrelevant 'whether the . . . state income tax infringes on appellant's rights as an individual Navajo Indian' ... To be sure, when Congress has legislated on Indian matters, it has, most often, dealt with the Tribes as collective entities. But those entities are, after all, composed of individual Indians, and the legislation confers individual rights. The Court has, therefore, held that 'the question has always been whether the state action infringed on the right of reservation Indians to make their own laws and be ruled by them.' In this case, appellant's rights as a reservation Indian were violated when the state collected a tax from her which it had no jurisdiction to impose.

McClanahan, 411 U.S. at 181 (quoting Williams v. Lee, 358 U.S. 217, 220 (1959)(emphasis in original)). State arguments that taxation of reservation Indians is justified by the services provided to them by the State were similarly rejected by the Court. See McClanahan, 411 U.S.

at 173 & n. 12 (noting substantial federal defrayment of state expenses, adding that “[c]onferring rights and privileges on these Indians cannot affect their situation, which can only be changed by treaty stipulation, or a voluntary abandonment of their tribal organization”)(quoting The Kansas Indians, 72 U.S. (5 Wall.) 737, 757 (1867)); accord Moe v. Salish & Kootenai Tribes, 425 U.S. 463, 476 (1976); and Lac du Flambeau Band of Lake Superior Chippewa v. Zeuske, 145 F.2d 969,975 (W.D.Wisc. 2000).

McClanahan and the other Supreme Court precedents cited above demonstrate that tribal members who are domiciled on their own reservation are not to be treated as state residents for state income tax purposes, and that the State of Minnesota is without federal authority to impose a “residence tax” on Indian persons residing on the reservation of their tribe. Yet, this is exactly what the State is doing in this case.

B. The Due Process and Commerce Clauses Bar State Taxation of Income of Reservation Indians Derived from Out-of State Sources

State tax authority depends upon state jurisdiction over the objects of taxation. The Due Process Clause requires “‘some definite link, some minimal connection, between a state and the person, property or transaction it seeks to tax,’ as well as a rational relationship between the tax and the ‘values connected with the taxing State.’” Midwestvaco Corp. v. Illinois Dept. of Revenue, ___ U.S. ___, ___, 128 S.Ct. 1498, 1505 (2008)(quoting Quill Corp. v. North Dakota, 504 U.S. 298, 305-06 (1992); Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-45 (1954); and Moorman Mfg. Co. v. Blair, 437 U.S. 267, 273 (1978)). The Commerce Clause “forbids the States to levy taxes that discriminate against interstate commerce or that burden it by

subjecting activities to multiple or unfairly apportioned taxation.” Id. In Wisconsin v. J.C. Penney Co.,⁴ the Supreme Court summarized the constitutional conditions for the exercise of state taxing power:

For constitutional purposes, the decisive issue turns on the operating incidents of a challenged tax ... if, by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society ... [T]he sole constitutional test ... is whether property was taken without due process of law, or, if paraphrased we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask in return.

J.C. Penney, 311 U.S. at 444 (emphasis added). See also Hunt-Wesson, Inc. v. Franchise Tax Board of California, 528 U.S. 458, 463-64 (2000)(“the ‘Due Process and Commerce Clauses ... do not allow a State to tax income arising out of interstate activities - even on a proportional basis - unless there is a ‘minimal connection’ or ‘nexus’ between the interstate activities and the taxing State, and ‘a rational relationship between the income attributed to the State and the intrastate values of the enterprise.’”)(quoting Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 165-66 (1983)).

Applying this constitutional test to the present case, the due process and commerce clauses do not permit the State of Minnesota to tax a tribal member’s out-of-state activities in the absence of an adequate nexus with the State justifying such taxation. Where the State confers the privileges of domicile to a resident, or the privileges of conducting business within

⁴ 311 U.S. 435 (1940)(upholding the constitutionality of the Minnesota income tax on corporate income earned within the State by a nonresident).

the State to a nonresident, this nexus requirement is met. See, e.g., Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-49 (1973)(upholding nondiscriminatory state taxation of tribal income earned off-reservation *elsewhere within the state*). In Mr. Houle’s case, as with other resident tribal members who derive income from out-of-state sources, neither benefit is conferred, and there is no nexus between the State and the income sought to be taxed.

1. Reservation Domicile Cannot Be Used By the State as a Basis for Taxation of a Tribal Member

The “simple but controlling question” presented in J.C. Penney – i.e. “whether the state has given anything for which it can ask in return” – must be answered in the negative when applied to state taxation of the out-of-state income of tribal members who are domiciled on their own reservation. In this case, Mr. Houle’s military retirement income was earned outside the territorial limits of the State of Minnesota, which leaves the privileges of domicile in the State as the only possible nexus for the State’s taxing authority. However, Mr. Houle’s right of domicile on the Fond du Lac Reservation is not conferred to him by the State of Minnesota, but is derived exclusively from his membership in the Fond du Lac Band.

The aboriginal right of members of the Fond du Lac Band to reside on the Fond du Lac Reservation pre-dates the establishment of both the United States and the State of Minnesota and is recognized in the various treaties between the United States and the Lake Superior Chippewa. This antecedent right of domicile has long been recognized by the federal courts, operates exclusive of the State’s existence or sufferance, and is specifically recognized under the treaty that reserved the Fond du Lac Reservation to the Fond du Lac Band. See United

States v. Thomas, 151 U.S. 577, 582-85 (1894) (recognizing that the Treaty of LaPointe incorporated the prior tribal right of occupancy); see also Cardinal v. United States, 954 F.2d 359, 364 (6th Cir. 1992)(citing Thomas). It is, accordingly, the Fond du Lac Band and *not* the State of Minnesota that confers the privileges of residency enjoyed by members of the Band who reside on the Fond du Lac Reservation.

This conclusion under due process and commerce clause analysis is similarly supported by well-established principles of federal Indian law. The Supreme Court’s rejection in McClanahan of reservation domicile within a state as a sufficient, independent basis for state taxation controls the present case, because the State has no other basis for its tax. **If a tribal member’s residence on an Indian reservation within a state was alone a sufficient nexus to support state taxation of a member’s income, the McClanahan Court would have ruled in favor of the State, and further inquiry into the locus of the income at issue would have been unnecessary.**⁵

The State of Minnesota cannot tax Mr. Houle as a nonresident because he has no income

⁵ See also Moe v. Salish and Kootenai Tribes, 425 U.S. 463, 476 (1976)(striking down a Montana personal property tax on reservation Indians as a condition precedent for motor vehicle registration; also rejecting as insignificant the State’s argument that the tribe benefitted from state expenditures and that tribal members exercised political rights as state citizens); Bryan v. Itasca County, 426 U.S. 373, 376-77 (1976)(invalidating state imposition of a personal property tax on property owned by a tribal member on-reservation); and Washington v. Confederated Bands of Colville Reservation, 447 U.S. 134, 163-64 (1980)(rejecting an attempt by the State of Washington to avoid Moe by labeling a de facto personal property tax as an “excise tax” based on “ownership”). “Had the State of Washington tailored its tax to the amount of actual off-reservation use, or otherwise varied something more than mere nomenclature, this might be a different case ...” Id., 447 U.S. at 163-64. The Moe, Bryan and Colville decisions stand for the principle that state taxation of reservation Indians requires a clear, extra-reservation nexus to the State.

earned off of the Reservation within the State. His domicile does not provide a basis for taxing his extra-Minnesota income because he resides on his tribe's reservation, which is beyond the taxing jurisdiction of the State. Applying J.C. Penney, the State gives nothing to Mr. Houle to justify its tax and meet the nexus requirement,⁶ and the McClanahan principle controls:

[I]t cannot be doubted that the reservation of certain lands for the exclusive use and occupancy of the Navajos and the exclusion of non-Navajos from the prescribed area was meant to establish the lands as within the exclusive sovereignty of the Navajos under general federal supervision. It is thus not surprising that this court has interpreted the Navajo treaty to preclude extension of state law – including state tax law – to Indians on the Navajo reservation.

McClanahan, *supra*, 411 U.S. at 174-75. The Court's conclusion that the tribal member's "rights as a reservation Indian were violated when the state collected a tax from [him] which it had no jurisdiction to impose," 411 U.S. at 181, applies here as well.

2. Interstate and International Principles Prohibit State Taxation of Out-of-State Income of Tribal Members Domiciled on Their Reservation

The limitations on state authority to tax the out-of-state earnings of a reservation Indian are similarly supported by rules of interstate and international taxation. This is the approach adopted by the Supreme Court in Oklahoma Tax Comm'n v. Sac and Fox Nation, 508 U.S. 114 (1993) and Oklahoma Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 115 (1995). In Sac and Fox, the State of Oklahoma attempted to tax the income of tribal members employed by the Tribe on tribal land which was reserved under an executive agreement by which the Tribe had

⁶ As Judge Crabb observed in Zeuske: "Wisconsin has no nexus to the work Jackson performed in Minnesota. Therefore, it is left to the expedient of claiming Jackson's residence as a nexus, but it has no legal basis for doing so." Lac du Flambeau Band of Lake Superior Chippewa v. Zeuske, 145 F.Supp.2d 969, 976 (W.D. Wisc. 2000).

ceded its reservation. The Court reiterated that “[t]he residence of a tribal member is a significant component of the McClanahan presumption against state tax jurisdiction,” and confirmed that Indians who reside on their own reservations or other Indian country governed by their tribe are “outside the State’s taxing jurisdiction”. Id., 508 U.S. at 123.

In Chickasaw, the Court held that the McClanahan principle does not bar state income tax on tribal members residing in the State outside of Indian country, but earning wages on tribal trust land as employees of the Tribe, and that the “well-established principle of interstate and international taxation - namely, that a jurisdiction, such as Oklahoma, may tax all the income of its residents, even income earned outside the taxing jurisdiction” governed, and that a state may tax the income of tribal members who live within the State but outside Indian country, even if they earn their wages inside Indian country. Id., 515 U.S. at 462-63.

The Sac and Fox and Chickasaw decisions reinforce the established rules that a state can tax all income of Indians residing outside of Indian country based on their domicile elsewhere within the State, but that the principles of interstate and international taxation limit the State’s taxing authority over Indians residing on their reservation to that income which is actually earned outside the reservation and *within* the State’s boundaries. See also Kiowa Tribe of Oklahoma v. Manufacturing Technologies, Inc., 523 U.S. 751, 755 (1998)(“We have recognized that a State may have the authority to tax or regulate tribal activities occurring within the State but outside Indian country”)(citing Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-49 (1973) (emphasis added)). So, while tribal members residing on their reservation are considered state residents for some purposes, the controlling principles of federal Indian law require that they be

effectively regarded as nonresidents for state income tax purposes, and that some other nexus between the member, the member's income and the state must be established per J.C. Penney et al. In this case, the State of Minnesota cannot tax Mr. Houle's out-of-state income based upon his reservation residence.⁷

C. Application of the State Income Tax to a Band Member's Out-of-State Income Infringes Upon the Band's Right of Self-Government

The imposition of the Minnesota income tax on the out-of-state income of Band members residing on the Reservation also infringes upon Fond du Lac Band's inherent right to tax its members based on their reservation residency. The well-established principles of interstate and international taxation discussed above demonstrate that the Band is the appropriate sovereign with a residency-based tax nexus to its members and, therefore, reserves the right to tax Mr. Houle's extra-Minnesota income.

Under the Treaty of LaPointe, the Fond du Lac Reservation was "set apart" for exclusive use and occupancy by the Band. Id., Art. 2, 10 Stat. 1109 (Sept. 30, 1854)(Exhibit A). The two critical provisions of the Treaty were the concession of northeastern Minnesota to the United States (Art. 1), and the retention of continued insularity for the signatory Bands through their territorial reservations (Art. 2). See, e.g., Washington v. Washington State Commercial Passenger Fishing Vessel Ass'n, 443 U.S. 658, 680 (1979)("the treaty was not a grant of rights

⁷ Significantly, the Department of Revenue itself has recognized the distinction between Minnesota residency and reservation residency of tribal members, implicitly acknowledging that an Indian residing on his tribe's reservation is effectively a nonresident for tax purposes. See, e.g., Minn. Dept. Rev., "American Indians - Reservation Income Subtraction", http://www.taxes.state.mn.us/individ/other_supporting_content/american_indians_sub.shtml (Exhibit G).

to the Indians, but a grant of rights from them - a reservation of those not granted”(emphases added); and C. Wilkinson, American Indians, Time and the Law 14-19 (1987)(the goal of the treaties was to permanently secure a “measured separatism” for the tribes). The State’s attempt to levy a tax based solely upon a tribal member’s residence on the Reservation, whose very purpose is to provide a refuge for the Band from state authority, patently infringes upon the promise of insularity made by the Treaty.

Under federal law, Indian tribes retain “inherent sovereign authority over their members and territories.” Oklahoma Tax Comm’n v. Citizen Band Potawatomi Indian Tribe, 498 U.S. 505, 509 (1991)(citing Cherokee Nation v. Georgia, 30 U.S. (5 Pet.) 1, 17 (1831)). While the territorial component of tribal sovereignty is highly relevant “in determining whether state authority has exceeded the permissible limits”, White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 151 (1980), a tribe’s authority over it’s members may also extend beyond reservation boundaries where necessary to the exercise of inherent authority or rights reserved by treaty. See, e.g., Cohen’s Handbook of Federal Indian Law 602-03 (2005 ed.); see also Fond du Lac Band of Chippewa Indians v. Carlson, No. 5-92-159, slip op. at 29 (1996), aff’d sub nom. Mille Lacs Band of Chippewa Indians v. State of Minnesota, 124 F.3d 904 (8th Cir. 1997), aff’d, Minnesota v. Mille Lacs Band of Chippewa, 526 U.S. 172 (1999)(reaffirming tribal right to regulate ceded territory harvest activities of Band members reserved under treaty).

Tribal tax authority is inherent. See, e.g., Kerr-McGee Corp. v. Navajo Band, 471 U.S. 195,198-99 (1985); Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 137-42 (1982); and Washington v. Confederated Tribes of Colville Indian Reservation, 447 U.S. 134, 152 (1980).

The Supreme Court in Merrion emphasized the “significant territorial component to tribal power,” 455 U.S. at 142, and characterized tribal tax authority as “an essential attribute of Indian sovereignty because it is a necessary instrument of self-government and territorial management.” Id. at 137.

The Fond du Lac Band provides numerous services for which it can ask something in return, per J.C. Penney: police, fire, and medical services, public transportation, road maintenance, sanitation, conservation and environmental regulation, etc., as well as “‘the advantages of a civilized society’ that are assured by the existence of tribal government.” Merrion, supra, 455 U.S. at 137-38 (quoting Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 228 (1980) and Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 445 (1979)). The Band is the appropriate governmental taxing authority to tax Mr. Houle’s out-of-state income as it may deem necessary to defray the governmental services it provides to its members and to other residents of the Reservation.

Whether and to what extent the Band presently exercises its tax authority is not relevant to the current issue. See, e.g., Merrion, supra, 455 U.S. at 147-48 (tribal authority does not lapse through nonuse, but remains dormant in the sovereign); and Washington State Commercial Fishing Vessel Ass’n, supra, 443 U.S. at 669 & n. 14 (tribal rights are not extinguished through nonuse, acquiescence to state practices, or settled expectations of outside parties). While the Band currently does not impose an income tax on its members, it may become necessary in the future. As with most communities, the growth of the Fond du Lac economy and population require commensurate increases in governmental services and revenues. Consequently, the

State's attempt to tax tribal members purely based on their domicile within the Reservation boundaries, diminishes the Band's tax base, violates its territorial sovereignty, and infringes upon the Band's right to make its own laws and be ruled by them. Williams v. Lee, 358 U.S. 217, 220 (1959); cf. Crow Tribe v. Montana, 819 F.2d 895, 901-03 (9th Cir. 1987), sum. aff'd, 484 U.S. 1039 (1988)(state taxation of non-Indian activities on reservation over which a tribe has tax authority held as infringing upon tribal sovereignty and undermining federal policy objectives of encouraging tribal self-government and economic development).

D. The Minnesota District Should Follow *Lac du Flambeau Band of Chippewa v. Zeuske*

The only reported federal decision on the issue of state authority to tax the income derived from out-of-state sources by tribal members residing on their reservation is the case of Lac du Flambeau Band of Chippewa v. Zeuske, 145 F.Supp.2d 969 (W.D. Wis. 2000), in which the issue was raised by an Ojibwe Band whose reservation was also reserved under the Treaty of LaPointe. Id., 145 F.Supp.2d at 971. The Court, per Judge Barbara Crabb, held in Zeuske that the State of Wisconsin had no authority to tax the income of a Band member who resided on the Lac du Flambeau Reservation where the income was earned outside of the State as a truck driver for a company operating out of Minnesota. Id., 145 F.Supp. 2d at 971-72.⁸

The Court based its decision in Zeuske primarily on the failure of the State to produce any affirmative congressional authorization for imposing its tax, noting particularly that the

⁸ The Zeuske decision is cited in Cohen's Handbook of Federal Indian Law in support of the statement that "a state may not collect income tax from tribal members who reside in Indian country but earn income outside the state's boundaries." Id. at 695 & n. 207 (2005 ed.).

State's argument that benefits conferred by the State to reservation Indians justified the tax has long been discredited by Supreme Court precedent, id., 145 F.Supp.at 975 (citing Moe and McClanahan), and that imposition of the state tax failed to satisfy due process nexus requirements:

Left unexplained by defendant is the source of the state's authority to impose a tax upon Jackson. She simply asserts that once Indians leave their reservation to work, they are subject to taxation. Obviously, this is true, but it does not address the situation in which the off-reservation work is not performed within the state in which the reservation is located ...

Defendant cites no statute authorizing the state to impose taxes on Indians solely because of their residency on a reservation within the state. Her efforts to show that plaintiff's members receive benefits from the state is misguided [citing Moe and McClanahan] ...

By contrast, plaintiff's position is based upon established principles of federal Indian law that govern the taxation of Indian peoples and land and upon the due process clause of the United States Constitution, which requires a nexus between an activity and a state before the state can tax the activity [citing Hunt-Wesson and J.C. Penney] ...

The question plaintiff has raised is a close one [⁹]. In the end, however, it is impossible to escape the conclusion that the only basis on which defendant can defend its effort to collect income taxes from Jackson is his residency. It is the only nexus Wisconsin has. But because that residency is on a reservation, the state cannot use it as a nexus. Under due process principles, the state cannot use as a reason to tax a residence that it has not provided or permitted. Under federal Indian law, the state cannot tax Jackson solely because of his residency without running afoul of the holdings in [Chickasaw Nation, County of Yakima, and McClanahan] ...

⁹ Judge Crabb's characterization of the issue as being a "close one" is inexplicitly at odds with the exacting legal analysis that she has provided. The Band finds the inability of the State to advance federal authority for taxing the out-of-state income by Band members who are domiciled on the Reservation to be singularly dispositive of the issue.

Congress has never authorized the states to tax tribal members living on reservations solely because of their residence within the taxing state; without such authorization, Wisconsin has no legal right to tax Jackson or any other tribal member similarly situated. As plaintiff points out, if residence on a reservation were equivalent to residence within a state, a state could claim authority to collect a tax merely by showing that a tribal member lived on a reservation within the state's borders. If this were the law, the Supreme Court would not have barred the states of Arizona, Montana and Washington from imposing taxes on reservation Indians within their states [citing McClanahan, Moe and Colville].

Id., 145 F.Supp. 2d at 975-77. The Fond du Lac Band finds it to be significant that the State of Wisconsin did not appeal Judge Crabb's decision in Zeuske, but immediately revised state collection procedures to exempt out-of-state earnings by Indians residing on their reservation. See Wisc. Dept. of Revenue, Pub. # 405 (Dec. 2001), at 3 (Exhibit H).¹⁰

The State of Minnesota's position in this matter to-date is indistinguishable from that taken by the State of Wisconsin in Zeuske. The State is unable to meet its burden of producing any federal authorization for imposition its income tax on Mr. Houle's veterans pension. It's effort to tax the out-of-state income of Indians residing on their reservation must accordingly be invalidated and barred.

CONCLUSION

Controlling principles of federal Indian law and constitutional due process limitations prohibit the State of Minnesota from taxing income earned outside the State's boundaries by a tribal member who is domiciled on his or her reservation. The Fond du Lac Band accordingly

¹⁰ Following Zeuske, the State of Wisconsin now treats all military pay, annuities, social security and private retirement income of reservation Indians as exempt. See id., "Tax Status of Income Items", at 3, 4.

requests a declaration from this Court that the State may not impose an income tax under these circumstances, and a permanent order enjoining the State from doing so.

Respectfully submitted this 14th day of May, 2009.

s/Dennis J. Peterson

DENNIS J. PETERSON

Bar Number 0208036

Tribal Attorney

FOND DU LAC BAND OF LAKE SUPERIOR CHIPPEWA

LEGAL AFFAIRS OFFICE

1720 Big Lake Road

Cloquet, Minnesota 55720

Telephone: (218)878-2607

Fax: (218)878-2692