

**Testimony of Arlan Melendez
Chairman of the Reno Sparks Indian Colony**

**Before the House Judiciary Committee
Subcommittee on Crime, Terrorism and Homeland Security**

**H.R. 4081, the “Prevent All Cigarette Trafficking Act of 2007”;
H.R. 5689, the “Smuggled Tobacco Prevention Act of 2008”**

May 1, 2008

Mr. Chairman and honorable Members of the Committee, thank you for the opportunity to testify today on the tobacco regulation bills. I appreciate your consideration of tribal government views and hope that we can work together to resolve these issues of importance to Indian country. As always, we thank you for your commitment to upholding tribal self-government and the federal government’s trust and treaty relationships with Indian tribal governments.

I would like to begin with the observation that Indian reservations are subject to a system of dual taxation that undermines tribal governments’ ability to raise taxes and provide services. This is the fundamental reason that Indian reservations suffer from such significant problems with lack of law enforcement, roads, schools, and basic infrastructure that most Americans take for granted. The only solution to date has been for states and tribes to enter into compacts and agreements that allow the tribes to collect a tax.

The Reno Sparks Indian Colony is located in Nevada, where gaming is not an option for tribes. Instead, my Tribe’s source of revenue is generated from sales and excise taxes primarily on tobacco sales. In 1983 the State of Nevada passed a statute that holds state sales taxes inapplicable on Indian reservations if the tribal government collects a tax that is equal to the state tax. This applies to any product purchased on an Indian reservation whether it is a gallon of milk, a loaf of bread or a pack of cigarettes. This action by our State Legislature was recognition of tribal sovereignty and recognition of the need for tribal governments to generate revenue from taxes -- a need shared by every government in the world. It is also consistent with the concept of taxation and sovereignty between states. Even though I am a resident of Nevada, while I am here in the District of Columbia for this hearing, I expect to pay the DC sales tax. Why should tribal nations be treated any differently?

My Tribe has used its taxing authority to create a viable economic tax base which has allowed the Tribe to purchase land and attract business development to the reservation. Recently we completed the construction of a health clinic that provides services to all Indian people in the Reno area. We financed the health clinic through issuance of bonds backed by our tax revenues. In doing so, we saved the federal government a considerable amount of money as such clinics are normally built and paid for by the Indian Health Service. We derive our sales tax revenue in the same manner as a state or local government, and I believe more tribes should have this opportunity.

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The tax agreements in Nevada are a win for all parties. Tribal governments get a tax base, the State resolves its tax administration issues, other retailers get a more level playing field, and tribal governments are in a position to use their tax revenues to build partnerships with surrounding communities and contribute to public services and economic growth in their region.

However, tribal-state tax agreements are not based solely on good will, but also on the current state of federal law and a truce between tribes and states. We are always concerned when Congress considers federal legislation that would affect the collection and enforcement of state tobacco taxes. Tribes are concerned that new state enforcement authority will reignite tribal-state tobacco tax litigation, much of which has been put to rest through negotiated agreements. Tribes strongly believe that federal legislation must recognize the appropriate role of tribal governments and tribal taxation authority on Indian reservations. The Constitution of the United States specifically recognizes three forms of government – Federal, State and Tribal. I believe that Congress should consider Nevada as a model and work with tribes to develop federal law that would eliminate dual taxation and provide the opportunity for all tribes to raise revenue and provide services on their reservations.

Background

The Supreme Court's rulings on state taxation of sales between Indian sellers and non-Indian buyers are complex and the source of many misunderstandings. The Supreme Court has held that state governments can collect excise taxes on sales of imported products that occur on tribal lands to non-tribal members, *so long as the tax does not fall directly on the tribal government or a tribal member or does not burden revenues derived from value generated on the reservation by activities in which Indians have a significant interest*. At the same time, tribal governments retain their right to tax all sales within the reservation, whether to members or non-members. (see *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463 (1976); *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134 (1980).) There is frequent litigation between tribes and states over the fairness and interpretation of these common law rules, which have remained static while tax systems have changed dramatically.

The Supreme Court rulings result in the inequity of dual taxation where the collection of a state tax effectively prevents the tribal government from implementing its own tax, because the double taxation would drive business away from the reservation. On most reservations tribal members must go off reservation to purchase goods and services. The state gets all of those taxes, and it is estimated that as much as 80% of tribal members' incomes are spent off-reservation. When a non-Indian comes on reservation, the state gets that tax as well. In those instances, tribes can only collect taxes on sales to their own tribal members, and this is not a viable option when Native communities have the highest poverty rates in the country.

The tax rules are also very difficult to administer, because most states have moved to tax "pre-collection" system where the state tax is collected far upstream from the retail purchase where the Indian identity of the purchaser could be ascertained. This type of pre-collection system is the subject of S. 5689.

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In practice, the sale of cigarettes in Indian country is largely governed by cooperative agreements between states and tribes. According to a 1995 report of the Arizona Legislative Council, more than 200 tribes in 18 states have established successful state-tribal sales tax compacts that were mutually satisfactory to both parties. A number of significant agreements have been subsequently reached in states such as Arizona, Michigan and Washington where there are many Indian tribes with large reservations. In general, most of these agreements provide tax revenue to tribal governments and services for Indian communities. (As a side note, an updated study of tribal-state tobacco agreements might be a useful addition to this legislation.)

The earliest cigarette tax agreements simply exempted Indian purchasers on reservations from sales taxes or created an allocation of tax-free cigarettes for Indian purchasers. However, as states have turned to "pre-collection" of cigarette taxes at the wholesale level, the new laws necessitated the renegotiation of tribal-state tax compacts because pre-collection results in the state collecting taxes on the Indian purchaser in Indian country, which violates federal law (see, *Pourier v. South Dakota* 2003 SD 21.)

In more recent agreements under the "pre-collection" statutes, the tribe often adopts a tax that is equal to or within a close percentage of the state tax. The state generally collects the tax revenue from the wholesalers and makes a refund to the tribe under a specified formula. This system treats on and off-reservation sales equally, eliminates tax rate disparities, and eliminates double taxation.

In states such as Oklahoma, Wisconsin and Nebraska, the state and the tribe have agreed to divide the revenue from reservation sales based on an estimate of the volume of sales to tribal members. In states such as Arizona, Nevada, Washington and Mississippi, the state and the tribe have agreed that tribes will collect 100% of the tax revenues from reservation sales, whether the sales are to Indians or non-Indians. These arrangements take different forms, for example Arizona has adopted two ballot measures that establish coordinated taxing authority by the state and the tribes. Under Arizona law, if a tribe adopts a tobacco tax at a rate that is equal to the state's off-reservation tobacco tax, then the state does not impose a tax on any on-reservation sales. This type of agreement allows tribes to retain all tax revenues from on-reservation sales, just as the state retains all tax revenues from off-reservation sales. The advantage to the state is that it eliminates tax disparities and unfair competition concerns while it creates a more significant source of revenue that allows tribes to provide more governmental services.

States such as Louisiana and New Mexico have exempted all on-reservation sales from state taxation. These states avoid double taxation and recognize such sales as an important source of income for tribes. This approach acknowledges to the fullest extent possible the need for tribal governments to make their own taxation decisions in order to fund governmental services and/or to encourage economic development. The State of New York is essentially like Louisiana and New Mexico. Although there is no explicit exemption, New York has agreed not to enforce state tobacco taxes on the Indian reservations because of respect for tribal sovereignty and the longstanding treaty agreements between the State and the New York tribes.

Tribes are committed to protecting the existing agreements between states and tribes on tobacco taxes. These agreements provide a great deal of much needed tax revenue to tribal governments,

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and have served as a starting point for improved tribal-state interactions. Because these tribal-state compacts and agreements address the unique nature of each state's taxing scheme, and the manner in which tobacco products sold to Indians on Indian lands is to be handled, a new Federal scheme -- which is based upon an inaccurate assumption that all tobacco products are sold under a state taxation system -- holds the potential to wreak havoc on the existing state-tribal taxation frameworks and restart the tribal-state cigarette tax litigation which has been put to rest through negotiated agreements.

H.R. 5689, The Smuggled Tobacco Prevention Act

Our primary concerns relate to H.R. 5689 because it appears to have been drafted without any recognition of tribal regulatory authority, tribal exemption from state authority on reservation, or the state-tribal tobacco tax agreements. The bill envisions that the Secretary of Treasury will establish a system for requiring codes on the labels of tobacco products for the purpose of tracing tax collection through the distribution system. The system would include not only the collection of federal taxes, but also includes broad regulatory authority to coordinate and facilitate collection of state taxes. State governments would be given broad new enforcement mechanisms, while there is no acknowledgement of the laws that protect tribal authority and immunities on the reservations. For example:

- Section 201 of the bill would make it a federal crime for any person to possess more than ten cartons of cigarettes without a state license or other state authority. State licensing and regulation is not applicable on Indian reservations.
- Currently the Contraband Cigarette Trafficking Act applies to “applicable state taxes” which provides the exemption for taxes which are inapplicable on Indian reservations. Section 201 of the bill would create all new definitions for the CCTA and would make it a federal crime to possess more than ten cartons of cigarettes that do not bear evidence of payment of the state tax – without any reference to whether or not the state taxes are applicable on Indian lands.
- Section 202 would create a right of action for states to enforce the federal Jenkins Act, without a corresponding limitation on state authority on Indian lands.
- Section 102(a)(2)(b) contains the only explicit reference to Indian tribes, and would create a requirement that every package of tobacco sold on an Indian reservation “shall be visibly and prominently labeled as such.” Nevada and most other states and tribes have already developed tax stamp and labeling requirements within their tribal-state compacts, and this provision would seem to add an unnecessary and burdensome requirement that would conflict with the compacts.

I strongly urge that a comprehensive savings clause be added to protect existing tribal tax and regulatory authorities, tribal government immunities and state-tribal agreements. Section 6 of H.R. 4081 could be used as a model. In addition, S. 5689 should be amended so that tribal governments are integrated into the bill as appropriate tax collection entities on the same basis as state governments.

My final concern, however, is that a savings provision alone will not be enough to protect tribal tax and regulatory authority from a broad expansion of state tax enforcement power as envisioned in this legislation. The goal of this legislation is to create an electronic tax collection network so tight that the only source of tobacco will be through large manufacturers and distributors under strict electronic surveillance by the state governments. In short, tribal retailers will have no source of inventory not already taxed by the state. Any state would be tempted to use this new power as leverage to force revenue concessions from the tribes.

I would urge the Committee to consult with tribal governments on provisions that would use the Nevada statute as a model and develop federal preemption provisions that would shield tribal taxes and eliminate dual taxation – providing the opportunity for all tribes to raise revenue and provide services on the reservations. Such a law would also respect the right of tribal governments to regulate and tax sales activities on their lands.

As I noted above, most states have already agreed to allow tribes to collect tax revenue under single tax systems, even where imposition of the state tax is permitted under federal law. The tribal-state agreements have a significant commercial and public health benefit in reducing or removing price disparities, and I believe Congress should consider legislation that would preempt state tobacco taxes when there is a comparable tribal taxation framework in place, not as a solution that would be forced on the tribes, but as an option for tribes and as an incentive for both states and tribes to resolve any remaining disputes over tobacco taxes.

The Campaign for Tobacco Free Kids has supported this type of legislation and originally drafted the following language with the provision that the tribal tax would be equal to or greater than the state tax. I would suggest that Congress also consider a level of tribal taxes at 80% of state cigarettes taxes because of tribes' concerns for the individual Indians who retail tobacco on reservation. On a number of reservations, selling tobacco has been one of the few economic opportunities available to individuals who live in impoverished Indian communities. A tax rate that is slightly lower than the surrounding jurisdiction would provide an opportunity for Indian businesses that sell cigarettes to stay in business. However, an 80% tribal tax would provide a significantly lower tax differential than is found at most state borders. (For example, the State of Virginia has a \$3.00 per carton tax, while the District of Columbia has a \$10.00 per carton tax, and Maryland has a \$20.00 per carton tax. The reality is that there are large tobacco tax differentials throughout the states that are built into our federalist system of government.)

This preemption concept could be accomplished through the following amendment:

A new Section 2345A is inserted into that title [Trafficking in Contraband Cigarettes or Tobacco Products] as follows:

Sec. 2345A. – Indian Tribes

Notwithstanding any other provisions in this Act, Indian Tribes shall not be required to collect or remit any State excise taxes on cigarettes or smokeless tobacco sold or delivered on or from land owned or occupied by the Indian Tribe if the Indian Tribe levies and collects a Tribal excise tax on any cigarettes or smokeless tobacco sold or delivered by any person

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located on the Tribal Land that is equal or greater than 80% of the excise tax placed on cigarettes or smokeless tobacco by any State in which the Tribal land is located or which the Tribal land adjoins and, for delivery sales, is equal or greater than 80% of the excise tax placed on cigarettes and smokeless tobacco by the State in which the buyer is located when the purchase is made or when the buyer obtains physical possession of the cigarettes or smokeless tobacco.”

H.R. 4081, Prevent All Cigarette Trafficking Act

As you know, the Prevent All Cigarette Trafficking Act has been pending in Congress for several sessions. In 2004, tribes worked with Congress to address our concerns and the result of those negotiations is found throughout the bill and in the savings clauses of Section 6. We greatly appreciate Congress’s willingness to work with us.

The legislation has changed since 2004, and some modifications may be needed to bring the tribal provisions up to date. In particular, some of the enforcement and reporting requirements should include tribal governments, and the federal government should work through tribal governments, not state governments, to accomplish federal objectives in Indian Country, particularly where tribes have established comprehensive regulatory and taxation structures.

I also want to encourage the Committee to consider for the PACT Act the suggestion I made above regarding a preemption provision for delivery sales. Internet tobacco smoke shops are not common in Indian country, but on a few reservations they have become an important source of economic activity for individual tribal members in locations where there are few jobs. A preemption provision could bring resolution to this sometimes controversial issue.

H.R. 1108, The Family Smoking Prevention and Tobacco Control Act

Although this legislation is not pending before the Judiciary Committee, I include it here because it has some provisions that overlap with S. 5689. Indian tribal governments strongly support efforts to prevent youth smoking, but we are concerned that the legislation’s tax enforcement provisions would significantly affect aspects of tribal self-government.

H.R. 1108 would grant broad authority to the Food and Drug Administration (FDA) to regulate the sale, advertising and manufacture of tobacco products and to enforce Federal statutes relating to Federal and state taxation of tobacco. In Section 103(g) the legislation contemplates that the FDA will contract with state governments to carry out inspections and enforcement. However, with the exception of a few states that were authorized to exercise some limited aspects of criminal jurisdiction under a Federal law enacted in the 1960’s, states do not have law enforcement jurisdiction on Indian lands. H.R. 1108 would thus effect a significant change in the manner in which criminal jurisdiction is exercised by the Federal government and tribal governments in Indian country.

Our second concern relates to Title III of the bill, entitled “Prevention of Illicit Trade in Tobacco Products.” This title envisions that the FDA will establish by regulation a system for requiring codes on the labels of tobacco products for the purpose of tracing tax collection through the

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distribution system, much like the system proposed to be carried out in the Department of Treasury in S. 5689. I have parallel concerns regarding this bill as those mentioned above. Also, this section authorizes enforcement by officers “duly designated by the Secretary.” Clearly, this language would enable the FDA to designate state officers to enforce Federal law in Indian country – a fundamental intrusion upon the sovereignty of tribal governments.

Conclusion

We very much appreciate your consideration of our views on this topic. We look forward to working with you and hope that together, we might resolve these issues of importance to Indian country. Once again, we thank you for your commitment to upholding the Federal government’s trust and treaty relationships with Indian tribal governments.
