

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

ONEIDA NATION OF NEW YORK,

Plaintiff,

v.

DAVID A. PATERSON, in his official capacity as Governor of New York, JAMIE WOODWARD, in her official capacity as Acting Commissioner of the N.Y. Department of Taxation & Finance, WILLIAM COMISKEY, in his official capacity as Deputy Commissioner for the Office of Tax Enforcement for the N.Y. Department of Taxation & Finance,

Defendants.

Civil Action
No. 6:10-CV-1071
(DNH/ATB)

**DEFENDANTS' MEMORANDUM OF LAW
IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT**

INTRODUCTION

In this litigation, the Oneida Nation of New York filed a pre-enforcement challenge to recent amendments to the New York Tax Law governing the collection of cigarette taxes from sales to nonmembers of the nation or tribe on Indian reservations. In May, the U.S. Court of Appeals for the Second Circuit held that the Oneida Nation's claims were meritless. Because there can no longer be any dispute that the Nation's claims fail as a matter of law, this Court should grant State defendants' motion for summary judgment.

ISSUE PRESENTED

Whether the 2010 amendments to the Tax Law violate tribal sovereignty.

STATEMENT OF THE CASE

A. Statutory and Regulatory Background

1. New York's Cigarette Taxes

Cigarettes enter the New York market when manufacturers sell cigarettes to state-licensed stamping agents, which are the only entities permitted to place cigarettes into commerce in the State. *See* 20 N.Y.C.R.R. § 74.3(a)(1)(iii). Stamping agents (who may also be wholesalers) sell cigarettes to other wholesalers and/or retailers, and the retailers sell them to the ultimate consumers (Smirlock Aff. ¶ 3, Dkt. # 46-5).

Tax Law § 471(1) imposes an excise tax on all taxable cigarettes sold in New York. Tax Law § 471(2) provides that the ultimate incidence of and liability for the cigarette excise tax is on the cigarette consumer. But the chain of taxation begins with stamping agents, who are required to pay the excise tax (in addition to a prepaid sales tax) “prior to the time such cigarettes are offered for sale” in New York. 20 N.Y.C.R.R. § 74.3(a)(2). Thus, in the normal course, stamping agents advance the excise tax by purchasing cigarette excise tax stamps, which they affix to each pack of cigarettes as evidence that the excise tax has been paid. The cost of the taxes is then passed on through subsequent purchasers and eventually borne by the ultimate consumers. *Id.* § 74.1(b)(1).

2. New York's Attempts to Tax Reservation Cigarette Sales Before 2010

Under federal law, reservation Indians are exempt from the State's cigarette taxes for cigarettes that they purchase on their reservations for their personal consumption. But the State has undisputed authority to tax "[o]n-reservation cigarette sales to persons other than reservation Indians." *Dep't of Taxation & Finance of N.Y. v. Milhelm Attea & Bros.*, 512 U.S. 61, 64 (1994) [hereinafter "*Attea*"].

The 2010 amendments at issue in this case represent New York's most recent effort to collect cigarette taxes on Indian reservations. In 1988, the New York State Department of Taxation and Finance (the "Department") adopted regulations that in several respects paralleled the key features of the 2010 amendments. The regulations acknowledged that qualified Indians had the right to purchase cigarettes without the payment of state tax. *See* 20 N.Y.C.R.R. § 336.6(a) (1990) (repealed) (Defendants' Mem., Exh. F). To ensure that only qualified Indians would be so exempted, however, the regulations restricted each nation or tribe's supply of tax-free cigarettes to a quantity "related to the probable demand of qualified Indian consumers in the trade territory of the exempt Indian nation or tribe." *Id.* § 336.7(d)(1) (1990) (repealed) (Defendants' Mem., Exh. G). The Department calculated each nation or tribe's probable demand based on data about per capita cigarette consumption and member populations. *See id.* § 336.7(d)(2)(ii) (1990) (repealed) (Defendants' Mem., Exh. G).

Under these earlier regulations, an agent seeking to sell tax-free cigarettes to a reservation cigarette seller or other qualified purchaser was required to obtain the Department's prior approval before completing any such sale. *See id.* § 336.7(c)(2) (1990) (repealed) (Defendants' Mem., Exh. G). The Department implemented this preapproval requirement through a coupon system under which it sent reservation cigarette sellers a certain number of coupons each month "entitling them to receive a predetermined quantity of tax free product." Brief for Petitioner, 1993 WL 664655, at *12, *Dep't of Taxation & Finance of N.Y. v. Milhelm Attea & Bros.*, 512 U.S. 61 (1994) (No. 93-377). An agent could sell tax-free cigarettes to a reservation cigarette seller only if the agent received coupons from the seller and turned them in to the Department. *See id.* at *13.

Before these regulations could come into effect, several wholesalers sued the Department to permanently enjoin the regulations. In the 1994 case *Attea*, the Supreme Court upheld the regulations, specifically approving both the probable-demand limitations and "[t]he associated requirement that the Department preapprove deliveries of tax-exempt cigarettes." 512 U.S. at 75-76.

In 1997, New York began implementation of the *Attea* regulations, but the State suspended its collection efforts following "civil unrest, personal injuries and significant interference with public transportation on the State highways" caused by protesting nation and tribal members. *N.Y. Ass'n of Convenience Stores v. Urbach*, 275 A.D.2d 520, 522-23 (3d Dep't 2000). The Department announced that it would forbear from collecting and repealed the regulations in 1998. *See Cayuga*

Indian Nation of N.Y. v. Gould, 14 N.Y.3d 614, 625-26 (2010), *cert. denied*, 131 S. Ct. 353 (2010).

Over the next several years, New York and the Indian nations and tribes were unable to reach agreement regarding cigarette-tax-collection issues. In 2003 and again in 2005, the Legislature amended the Tax Law to direct the collection of cigarette taxes, but the Department continued to forbear. *See id.* at 627-28. The state courts held that the Department's forbearance prevented the Legislature's 2005 amendments from coming into effect. *See id.* at 649-50; *Day Wholesale, Inc. v. State*, 51 A.D.3d 383, 388-89 (4th Dep't 2008).

In February 2010, the Department formally revoked the forbearance policy (Smirlock Aff. ¶ 6, Dkt. # 46-5). On June 21, 2010, the Legislature enacted the amendments that are at issue in these appeals (Defendants' Mem., Exh. D-E). One day later, the Department issued an emergency rule in connection with the statute's implementation (Smirlock Aff. ¶ 15, Dkt. # 46-5). Final regulations were promulgated on October 22, 2010. *See* 20 N.Y.C.R.R. § 74.6.

In light of the amended Tax Law and the Department's new regulations, the State immediately took steps to implement the 2010 amendments. In particular, the State moved to vacate two state-court preliminary injunctions that were based on statutes superseded by the 2010 amendments (Smirlock Aff. ¶ 26, Dkt. # 46-5). State Supreme Court granted the State's motion, and on September 14, 2010, the Appellate Division, Fourth Department agreed that the 2010 amendments could be implemented (Memorandum and Order, Dkt. # 12-2).

3. The 2010 Amendments

The New York State Legislature amended the Tax Law in June 2010 to facilitate the collection of the cigarette tax, including the tax due from sales on Indian reservations to nonmembers. The Legislature provided that the amendments apply beginning September 1, 2010, and established a timetable for preparations designed to meet that deadline. Laws of 2010, Ch. 134. (Defendants' Mem., Exh. D); Laws of 2010, Ch. 136 (Defendants' Mem., Exh. E).

With limited exceptions not applicable here, the 2010 amendments require stamping agents to prepay the tax and affix tax stamps on *all* cigarette packs sold in New York, including those intended for resale to qualified Indians on the reservation. See Tax Law § 471(2). However, two key features of the 2010 amendments—both patterned on the *Attea* regulations—ensure that Indian nations and tribes will have access to enough tax-free cigarettes to meet the demands of nation and tribal governments and their members for consumption.

First, as the *Attea* regulations did, the 2010 amendments allocate to each nation or tribe a quantity of tax-free cigarettes equivalent to the “probable demand” of the nations or tribes’ members for personal consumption. The Department’s method for calculating each nation or tribe’s probable demand ensures that a generous amount of tax-exempt cigarettes will be available for nation and tribal members. The Department’s calculations begin with each nation or tribe’s *entire* population, including children—a figure that the Department increases by an additional 10% to ensure the adequacy of its calculation. The enhanced population

figure is then multiplied by the United States' statistic for average annual cigarette consumption per capita for persons over 18. Finally, the Department considers any evidence of probable demand submitted by nations or tribes, such as prior sales data or other statistics. The Department recalculates each nation or tribe's probable demand amount annually. *See* Tax Law § 471-e(2)(b); 20 N.Y.C.R.R. § 74.6(e).

Second, the 2010 amendments provide two alternative mechanisms by which Indian nations or tribes can make this tax-exempt supply available to their members: a coupon system, and a prior approval system. The regulations provide that the nations or tribes may elect to use the coupon system each year by August 15, and if a nation or tribe does not make this election, the prior approval system applies. *See* 20 N.Y.C.R.R. § 74.6(b). The Department has provided by regulation that it will also permit late elections of the coupon system. *See id.* § 74.6(b)(1)(ii).

Under the coupon system, the Department distributes tax-exemption coupons each quarter to a nation or tribal government in an amount reflecting the nation or tribe's probable demand. *See* Tax Law § 471-e(2)(a). The nation or tribal government may retain any coupons necessary for its own purposes and is then expected to distribute the remaining coupons among reservation cigarette sellers, including those owned by the nation or tribe itself. A reservation cigarette seller can present the coupons to a wholesaler or stamping agent in order to purchase stamped cigarettes without paying the cost of the tax; the reservation retailer can then sell those cigarettes tax-free to members for their consumption. *Id.* The

wholesaler or stamping agent, in turn, can submit the tax-exemption coupons to the Department to obtain a refund of the tax that it prepaid (but did not collect) on these cigarettes. *Id.* § 471-e(4).

For any nation or tribe that does not elect the coupon system, the alternative prior approval system applies instead. *See* Tax Law § 471(5)(a); 20 N.Y.C.R.R. § 74.6(b)(3). Under that system, no coupons are distributed, and nation and tribal governments are not involved in the distribution of tax-free cigarettes on the reservation. Instead, as under the *Attea* regulations, when a wholesaler or agent intends to sell stamped cigarettes within the probable-demand amount to an Indian nation or tribe or reservation cigarette seller without the collection of tax, it must first obtain the Department's approval for that particular sale. *See* 20 N.Y.C.R.R. § 74.6(d)(3). The Department has set up a website through which wholesalers and agents can request approval. Upon receiving the Department's approval, the wholesaler or agent must complete the tax-free sale and report its details to the Department within 48 hours. If it does so, then the number of cigarettes sold is subtracted from the relevant nation or tribe's total allotment of tax-free cigarettes. In the aggregate, all such sales in a quarter cannot exceed the nation or tribe's quarterly probable-demand amount. (TSB-M-10(6)M at 5-6, *Seneca Nation of Indians* (No. 10-cv-00687), Dkt. # 4-6.)

B. Factual Background

The Oneida Nation "owns and operates retail outlets" on its lands (Decision and Order at 11, Dkt. # 61). Through these outlets, the Nation directly purchases

cigarettes from wholesalers and maintains inventories for sale to both members and nonmembers (Rebich Aff. ¶¶ 6-10, Dkt. # 13). Under the 2010 amendments, the Nation, like all other cigarette retailers, would purchase cigarettes for resale to nonmembers at a price that includes the prepaid cigarette tax and recoup the cost of the cigarettes, including the prepaid tax component, when it ultimately completes a retail sale.

The Oneida Nation has long tolerated and even encouraged a vast quantity of tax-free cigarette sales to nonmembers. In 2009 the Nation sold over 1.5 million cartons of cigarettes tax-free, despite having a population of only 1,500 and a probable demand of only 12,480 cartons per year (Smirlock Aff. ¶¶ 27-28, Dkt. # 46-5). Given these numbers, it is apparent that the vast majority of the Nation's cigarette economy—indeed, over 99% of its overall cigarette trade—consists of sales of untaxed cigarettes to nonmembers.

After the passage of the 2010 amendments, the Oneida Nation declined to present evidence of its probable demand. In addition, the Nation declined to elect into the coupon system. (Smirlock Aff. ¶¶ 18, 20, Dkt. # 46-5.)

C. Procedural Background

On September 7, 2010, the Oneida Nation commenced its action for declaratory and injunctive relief in this Court (Compl., Dkt. # 1). The Nation asserted that the 2010 amendments violated its tribal sovereignty rights in two ways. First, the complaint alleged that the 2010 amendments impermissibly required the Nation, as a cigarette retailer, to purchase cigarettes for non-member

sales at a price that included the cost of the tax (Compl. ¶¶ 26-36). Second, the complaint alleged that the prior approval system impermissibly burdened the ability of the Nation's members to purchase cigarettes tax-free (Compl. ¶¶ 37-51). The complaint raised no objection to the coupon system.

On October 14, 2010, this Court granted the Oneida Nation's request for a preliminary injunction (Dkt. # 61). Defendants filed an expedited appeal with the Second Circuit. On May 9, 2011, the Second Circuit issued a decision vacating this Court's grant of a preliminary injunction. *Oneida Nation of New York v. Cuomo*, 645 F.3d 154 (2d Cir. 2011) (Defendants' Mem., Exh. A). The Second Circuit concluded that the Nation had failed to demonstrate a likelihood of success on the merits of any of its federal claims. *Id.* at 175-176. On May 16, 2011, the Court ordered that the mandate issue forthwith, and the mandate issued that day (Defendants' Mem., Exhs. B, C).

ARGUMENT

THE 2010 AMENDMENTS DO NOT VIOLATE TRIBAL SOVEREIGNTY

Summary judgment is appropriate where the record “show[s] that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56(c). Here, the Oneida Nation’s complaint raises a purely legal claim: it alleges that the 2010 amendments impose excessive burdens on its tribal sovereignty. The Second Circuit squarely concluded that these claims are meritless. Accordingly, this Court should grant defendants’ motion for summary judgment dismissing the complaint in its entirety.

A. New York May Precollect the Tax on Cigarettes Destined for Sale to Nonmembers.

New York collects the cigarette tax at the start of the distribution chain, from the non-Indian stamping agents that import cigarettes into the State. The tax is then included in the price of cigarettes destined for nonmember consumption until ultimately the nonmember consumer pays the tax. *See* Tax Law § 471(2); 20 N.Y.C.R.R. § 74.1.

The Oneida Nation has contended that the precollection of the tax violates its tribal sovereignty by unduly burdening its nonmember sales (Compl. ¶ 26-36). The Second Circuit rejected this claim, holding that the 2010 amendments’ precollection system was not “a categorically impermissible direct tax on tribal retailers.” 645 F.3d at 168. Indeed, the court found that “New York’s precollection scheme is materially indistinguishable from those upheld in” *Moe v. Confederated Salish and*

Kootenai Tribes, 425 U.S. 463 (1976), and *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 156 (1980). *Oneida Nation*, 645 F.3d at 169. Accordingly, the Oneida Nation’s challenge to the precollection of the cigarette tax fails as a matter of law.

B. The Coupon and Prior Approval Systems Are Permissible Means of Allocating the Probable-Demand Amount on the Reservation.

The coupon and prior approval systems are New York’s alternative mechanisms for ensuring that a quantity of tax-exempt cigarettes sufficient to meet probable demand is available to the nations or tribes and their members. Where the two systems differ is in the manner by which they allocate this tax-exempt quantity to member Indians. Under the coupon system, nation and tribal governments determine how the tax-exempt quantity is allocated among the nation or tribe and its reservation cigarette sellers. Under the prior approval system, the tax-exempt quantity is allocated pursuant to a market-based system without nation or tribal governments’ direct involvement.

As the Second Circuit recognized, “the main features of the amended tax law’s probable demand and allocation mechanisms are substantially similar to those of the 1988 version upheld against a preemption challenge in” *Attea*. 645 F.3d at 170. As the court held, the 2010 amendments’ allocation systems properly respect tribal sovereignty and reasonably provide qualified Indians with access to tax-free cigarettes.

1. Coupon System

Under the coupon system, the Department provides each Indian nation or tribe with coupons up to the nation or tribe's quarterly allocation of its probable-demand amount. The coupon system imposes no further requirements on nation and tribal governments. Instead, it leaves to the governing bodies of each nation or tribe the sovereign decision of how to distribute these tax-exemption coupons to their members and businesses.

The Oneida Nation did not challenge the coupon system in this litigation. In *Oneida Nation*, however, the Second Circuit held that the coupon system did not infringe on the sovereignty of the Cayuga Indian Nation. *See* 645 F.3d at 171. The Cayuga Indian Nation and the Oneida Nation both operate their tobacco economies in the same manner: both “centralize tobacco retail within their respective territories,” *id.* at 163, by owning and operating the retail outlets in their territories (Decision and Order at 11, Dkt. # 61). As a result, the Second Circuit's holding that “the coupon system does not impose allocation burdens on the Cayuga Nation because its government owns and operates the Nation's two cigarette retailers,” *id.* at 171, applies as well to the Oneida Nation.

It is immaterial that the Oneida Nation has declined to elect into the coupon system. For one thing, the Department's regulations permit late elections. *See* 20 N.Y.C.R.R. § 74.6(b)(1)(ii). More fundamentally, the Nation cannot make a tax scheme inadequate simply by boycotting it. Nor can the Nation expect to maintain access to tax-free cigarettes if it refuses to participate in a valid tax-collection

scheme. *Colville* held that the State would not “unnecessarily intrud[e] on core tribal interests” if it chose to seize all cigarette shipments to Indian nations or tribes that “refused to fulfill collection and remittance obligations which the State has validly imposed”—even when “the cigarettes in transit are as yet exempt from state taxation.” 447 U.S. at 161-62. Thus, tribal sovereignty is not infringed if an Indian nation like the Oneida Nation loses its access to tax-free cigarettes because it “do[es] not cooperate in collecting the State’s taxes.” *Id.* at 161.

Thus, under the Second Circuit’s decision, the coupon system provides a legal mechanism for the Oneida Nation to obtain tax-exempt cigarettes. The availability of the coupon system requires the Nation’s lawsuit to be dismissed regardless of the validity of the prior approval system (although, as argued below, and as the Second Circuit held, that system is also valid).

2. Prior Approval System

Under the prior approval system, wholesalers and agents are responsible for obtaining the Department’s approval before making any tax-free sale to a nation or tribe or reservation cigarette seller. *See* Tax Law § 471(5). “As written, the prior approval system imposes no regulatory burdens on [the Plaintiffs] or their retailers. It operates entirely off-reservation and involves only wholesalers and the Department.” 645 F.3d at 172.

In this Court, and in the Second Circuit, the Oneida Nation argued that the prior approval system is unduly burdensome because it “*might* have the effect of denying tribal members access to tax-free cigarettes and disrupting the current

functioning of [the Oneida Nation's] tobacco economies.” *Id.* Specifically, the Nation's complaint alleges that agents and wholesalers might use the prior approval system in a manner that would effectively deny tax-exempt cigarettes to the Oneida Nation and its members (Compl. ¶¶ 42-45). But the Second Circuit specifically rejected this claim because it rested on “consequences that, while possible, are by no means predictable.” *Id.* at 167 (quoting *Attea*, 512 U.S. at 69); *see also id.* at 173 n.20.

In particular, the Second Circuit found that the Oneida Nation's conjectures about the potential behavior of agents and wholesalers improperly ignored the likely effect of several factors that would ameliorate and even eliminate the posited harms. First, “the broader legal framework within which wholesalers and tribal retailers operate discourages wholesalers from abusing the prior approval system,” *id.* at 174, since both state and federal authorities may penalize abusive behavior. *See, e.g.*, 25 C.F.R. § 140.22 (“It is the duty of the superintendent to see that the prices charged by licensed traders are fair and reasonable.”); *Ashcroft v. U.S. Dep’t of Interior*, 679 F.2d 196, 198 (9th Cir. 1982) (recognizing that federal government may intervene “to protect the Indians from unethical traders’ exploitation of an essentially captive consumer market”). Second, “if wholesalers disregard the legal risks of monopolistic behavior, the Department has the flexibility to modify the prior approval system to deter such behavior.” 645 F.3d at 174. Third, the Oneida Nation “may foreclose the uncertainty associated with the prior approval system by entering formal agreements with the Department.” *Id.*

And finally, the Oneida Nation may act to prevent abusive practices by exercising its power as the sole purchaser of cigarettes on its territory or by regulating the State-licensed agents and wholesalers that operate on the reservation. *Id.* at 174 n.22.

In short, the Second Circuit concluded, the Plaintiffs “ultimately request that the tax law be enjoined prior to its implementation on the basis of hypothetical private behavior and the assumption that there will be no Department response. This kind of speculation cannot support a pre-enforcement injunction of a state taxation scheme that is valid as written.” 645 F.3d at 175. The hypothetical possibility that concerns about the 2010 amendments’ implementation may arise in the future does not justify keeping *this* action alive.

Accordingly, the Oneida Nation’s claims against the prior approval system also fail as a matter of law.

CONCLUSION

Defendants' motion for summary judgment should be granted.

Dated: Albany, NY
September 23, 2011

Respectfully submitted,

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