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Larry C. Boyd
Surplus Line Association of Oregon
9011 SW Beaverton-Hillsdale Hwy., Ste. 2A
Portland, OR 97225

Re: Taxation and Regulation of Surplus Lines Insurance in Indian Country

Dear Mr. Boyd:

We are writing in response to your request for our opinion regarding Oregon's authority to tax surplus insurance policies that cover exposures in Indian country within the state. You also asked us to address the state's authority to tax policies written for Indian tribes for exposures off the reservation. Finally, you asked if the state has the authority to otherwise regulate insurance carriers in Indian country; and, if not, then who is the appropriate regulatory body?

We caution that the areas of regulatory jurisdiction and taxation in Indian country are quite complex, and determinations of jurisdiction are often very fact-specific. Furthermore, this area of the law is dynamic. Therefore, we urge you to consider this opinion a general overview of the current state of the law, and to consult us or other legal counsel if you have questions about a specific factual situation.

In short, the state may not tax surplus lines insurance policies purchased by a tribe or tribal member covering exposures located on an Indian reservation. If, however, the policyholder is a non-Indian, it will be subject to the state tax unless the tax is preempted by federal law or substantially interferes with tribal self-government. Similarly, if the policy is purchased by a tribe to cover exposures located outside of the reservation, it will be subject to state taxation. Finally, Indian tribes generally have regulatory authority over non-Indian insurers and brokers doing business on the tribe's reservation. This is certainly the case when that entity has entered into a business relationship with the tribe or tribal members. In some cases, however, when the business activities of the insurer or broker do not involve the tribe or its members and the covered exposures are located on land owned by non-Indians within the boundaries of the reservation, regulatory jurisdiction may fall to the state.

EXPLANATION

The phrase "Indian country" is a legal term of art in federal Indian law, and it refers to lands located within the boundaries of an Indian reservation, dependent Indian communities and Indian allotments, whether or not they are located on a reservation. Indian country is generally subject to federal and tribal jurisdiction, and in some instance, state jurisdiction as well.

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The question of which is the appropriate sovereign to exercise civil regulatory jurisdiction in Indian country, the tribe or the state, is closely related to the question of taxation authority. However, there are some distinctions in how courts have analyzed these two issues. Therefore, I will discuss them separately here.[1]

Taxation Authority

In order to analyze whether the state may tax insurance policies covering exposures in Indian country, we must first determine where the "transaction" takes place. In most cases, this analysis focuses on where the parties reside, where the contract is executed, where payment is made, and where the goods or services are exchanged. In the case of a surplus lines insurance policy, the most significant factor is the location of the covered exposure, as coverage of that risk constitutes the "good or service" provided. The insurer is generally not located in Oregon or admitted to do business in Oregon; thus, Oregon's interest primarily derives from the fact that the covered property is located in the state. Oregon's Surplus Lines Insurance Law recognizes that the location of the exposure is highly significant for properly assessing Oregon's interest in taxing surplus lines insurance. That statute provides that policies which cover exposures located both inside and outside of Oregon shall only be taxed on the "Oregon portion" of the risks. ORS § 735.470(5). It follows, then, that for policies covering exposures located in Indian country, the "transaction" at issue takes place in Indian country. This is especially true if other factors, such as the negotiation and execution of the contract, take place in Indian country.

Indian Policyholder

The second part of the analysis focuses on the identity of parties. If the entity purchasing the surplus lines coverage is an Indian tribe or a tribal member, the state may not tax the transaction. That is because the "legal incidence" of the tax, in that case, would fall upon the tribe or tribal member purchaser. *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450, 458-460 (1995). The phrase "legal incidence of the tax" refers to the person or entity that actually bears the burden of paying the tax. In *Oklahoma Tax Commission*, the Supreme Court held that states may not tax transactions occurring in Indian country when the legal incidence of the tax rests on an Indian or a tribe, unless Congress expressly authorizes the state tax. *Id.* at 459. No federal statute expressly authorizes states to tax surplus lines insurance policies sold to Indians in Indian country.

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[1] It is important to note that Public Law 280 ("PL-280") does not affect this analysis. In 1953, Congress transferred to five states criminal and limited civil jurisdiction over Indian country within the state pursuant to PL-280. Oregon was one of the five, and it obtained jurisdiction over all Indian country within the state except the Warm Springs Reservation. However, the Supreme Court has since held that this transfer of jurisdiction did not include civil regulatory jurisdiction or taxation authority. *Bryan v. Itasca County*, 426 U.S. 373 (1976). Thus, PL-280 does not apply to the questions presented here.

Oregon's Surplus Lines Law clearly requires the policyholder to bear the burden of the premium tax, and not the insurer or the broker (the "surplus lines licensee"). ORS § 735.470 (1). That statute provides, in relevant part:

> The tax shall be collected by the surplus lines licensee as specified by the director, in addition to the full amount of the gross premium charged by the insurer for the insurance... the surplus lines licensee is prohibited from absorbing any portion of such tax and from rebating for any reason, any part of such tax.

Although the statute instructs the surplus lines licensee to pay the tax, the tax must be collected in full from the policyholder, as quoted above. The Supreme Court has held that the legal incidence of a tax does not always fall on the entity required to pay the tax. *United States v. State Tax Commission of Mississippi*, 421 U.S. 599, 607-608 (1975). Rather, when a statute requires that the tax be passed on to the purchaser (the policyholder, in this case), "this establishes as a matter of law that the legal incidence of the tax falls upon the purchaser." *Id.* at 608. Thus, in the case of surplus lines insurance, the policyholder bears the legal incidence of the premium tax. If the policyholder is an Indian or a tribe, the tax is barred. *Oklahoma Tax Commission*, supra.

Two states with large Indian populations have addressed this issue and come to the same conclusion. The Attorney General for the State of Arizona issued a formal opinion in 1995, where he concluded that the state's surplus lines premium tax "does not apply to surplus line insurance purchased by a federally recognized Indian tribe to cover risks on its own reservation." Ariz. Op. Atty. Gen. No. I95-13. The Attorney General found that the tax was preempted because it interfered with the tribe's right to self-government, and, further, it was barred by *Oklahoma Tax Commission* as a direct tax on the tribe. *Id.* Following this opinion, the legislature of the state of Oklahoma amended its surplus lines law in 1999 to clarify that the premium tax does not apply to Indian tribes in Indian country. The amendment added the following sentence:

> Policies sold to federally recognized Indian tribes shall be reported as provided in Section 1107 of this title; however, such policies shall be exempt from the surplus line tax to the extent that the Insurance Commissioner can identify that coverage is for risks which are wholly owned by a tribe and located within Indian Country, as defined in Section 1151 of Title 18 of the United States Code.

36 Okl.St. § 1115. Similarly, the state of Oregon may not tax surplus lines insurance policies sold to Indian tribes for exposures located in Indian country.

Non-Indian Policyholder

If the entity purchasing the insurance policy is a non-Indian, the analysis becomes much more complicated. Several Indian reservations in Oregon and other states have a "checkerboard" ownership pattern. This means that the land within the reservation is not entirely owned or held in trust for the tribal or tribal members. Because of former federal policies – now abandoned – aimed at terminating tribal existence, large portions of reservation lands were allowed to pass into non-Indian ownership. Thus, on a checkerboard reservation, parcels of land may be owned in fee-simple by non-Indians. However, regardless of ownership, land within reservation boundaries is Indian country under federal law. This situation means that non-Indians may, in some cases, purchase surplus lines coverage for exposures located within Indian country.

Unfortunately, there is no bright-line rule with regard to the authority of the state to tax such transactions. The Supreme Court has held that determinations of state authority to tax non-Indian activity in Indian country require "a particularized inquiry into the nature of the state, federal, and tribal interests at stake." *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 145 (1980). While such taxes are not automatically prohibited, the state must overcome two "independent but related barriers" to state authority. *Ramah Navajo School Board v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 837 (1982), quoting *White Mountain*. Those are: 1) the exercise of state authority may be pre-empted by federal law; or 2) state authority may unlawfully interfere with tribal self-government.

Thus, the state of Arizona was prohibited from imposing a motor carrier license fee and fuel use taxes on a non-Indian logging company doing business with the White Mountain Apache Tribe on the reservation. *White Mountain*, supra. The taxes were preempted by the comprehensive federal regulatory scheme regarding Indian timber interests. *Id.* at 146-149. Further, the state had little interest in taxing the activity of the logging company, as it did not provide services to the company related to the tax. The company's activities were almost entirely on-reservation, on roads maintained by the tribe or the Bureau of Indian Affairs. *Id.* at 150. Thus, the "particularized inquiry" in this weighed against state taxing authority.

Similarly, in *Ramah School Board*, supra, the comprehensive federal involvement in educating Indian children preempted the state of New Mexico from applying a gross receipts tax to a non-Indian contractor building a school on the Navajo reservation. The state tax was not related to any government service provided to the contractor related to this project on the reservation. *Id.* at 843. Further, the tax would have an economic impact on the Tribe, interfering with tribal self-government and federal policy. *Id.* at 841-842. Thus, the tax was barred.

On the other hand, in *Cotton Petroleum Corporation v. New Mexico*, 490 U.S. 163 (1989), the Supreme Court held that state oil and gas taxes could be imposed upon a non-Indian company engaged in oil production activities on the Jicarilla Apache Reservation. Although there were extensive federal and tribal regulations regarding the activity, the state also regulated the

"spacing and mechanical integrity" of the company's oil wells, and provided other governmental services to the company. *Id.* at 185-186. Finally, the court found that the economic burden of the taxes would not affect the Tribe. *Id.* at 185. Thus, the "particularized inquiry" here weighed in favor of state taxation.

These cases are very fact specific, but generally Oregon may impose its surplus lines tax on non-Indians for exposures located on a reservation unless the facts of the case weigh in favor of preemption. For example, if the non-Indian policyholder is engaged in a business activity with a tribe on the reservation, and that activity is subject to comprehensive federal control (such as logging), and the covered exposure relates to that activity, the state tax may be preempted.

Exposures off the Reservation

In cases where an Indian tribe purchases surplus lines insurance coverage for exposures located off the reservation, the state tax will apply. Again, the initial inquiry is: where does the transaction being taxed take place? As stated above, the nature of surplus lines insurance regulation argues strongly that the transaction takes place where the covered exposure is located. Thus, for an exposure off the reservation, the transaction takes place off the reservation.

Indian tribes are not broadly immune from state taxation related to their activities outside of Indian country. *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 155 (1973). In that case, the Supreme Court held that a state sales tax applied to the Tribe for goods and services sold in connection with a tribally-owned ski resort located off the reservation. The Court stated: Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to non-discriminatory state law otherwise applicable to all citizens of the state." *Id.* at 148. Thus, for transactions off the reservation, tribes are generally subject to any applicable state tax.

Civil Regulatory Jurisdiction

A line of cases, which is generally separate from but related to the taxation cases, addresses the issue of civil regulatory jurisdiction in Indian country. Generally, tribes have exclusive regulatory jurisdiction over activities that take place on Indian-owned lands within reservation boundaries. However, the Supreme Court has held that tribes no longer retain complete inherent sovereign authority over those portions of the reservation that have lost their "Indian" character. Thus, in *Montana v. United States*, 450 U.S. 544 (1981), the Court held that the Crow Tribe could not regulate hunting and fishing on lands owned in fee-simple by non-Indians within the reservation boundaries. Similarly, in *Brendale v. Confederated Tribes and Bands of the Yakima Nation*, 492 U.S. 408 (1989), the Court held that the Tribe had exclusive authority to zone areas of the reservation which were closed to outsiders and retained their "pristine" condition, but the county had zoning authority over open, and more developed, portions of the reservation.

The Supreme Court articulated an exception to this rule in the *Montana* case. That is, a tribe may regulate the activities of non-Indians even on non-Indian-owned fee land within the reservation, if those activities fall into one of two categories. First, a tribe has authority over non-Indians who enter into a consensual relationship with the tribe; for example, by doing business with the tribe or its members. Second, the tribe may regulate activities of non-Indians that "threatens or has some direct effect on the political integrity, economic security, or the health or welfare of the tribe." *Montana* at 566.

Thus, as in the taxation analysis, the first question to be addressed is the location of the regulated "transaction." For reasons explained above, in the case of surplus lines insurance regulation, the transaction probably takes place where the covered exposure is located. If the transaction occurs on Indian-owned lands, the tribe probably has exclusive regulatory authority and the state regulations would not apply to that transaction.

If, however, the transaction occurs on on-Indian owned land within the reservation, the jurisdictional question becomes more complicated and fact dependent. For example, if the policy covers an exposure that has a significant impact on the health or well-being of the tribal population, the tribe might have exclusive jurisdiction. On the other hand, if the policy covers an exposure on an isolated parcel of the reservation and has little or no effect on the tribe or its members, the state probably exercises regulatory jurisdiction, and Oregon's Surplus Lines Law would apply.

CONCLUSION

As you can see, the issues raised in your inquiry are very complex. However, in one situation the law is clear. That is, the state of Oregon may not tax surplus lines insurance policies sold to Indian tribes for exposures located on the tribe's reservation. Other situations may require a more particularized analysis into the specific facts presented.

We hope this letter provides a general understanding of the questions you presented to us. We realize this is a complex area of the law, and would be happy to provide further explanation or answer specific questions.

Sincerely,

DENNIS C. KARNOPP
DCK/mlm