



Legal ALERT!

INDIAN LAW

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The Battle Over Untaxed Indian Cigarette Sales Continues

Municipalities continue to attempt to control the sale of untaxed cigarettes by Indian-owned stores to non-Indians. Two recent decisions have created a substantial rift in the jurisprudence concerning such sales. The New York State Supreme Court, Appellate Division, Fourth Department (“Fourth Department”), in *Cayuga Indian Nation v. Gould*, 2009 N.Y. App. Div. LEXIS 5667 (4th Dep’t July 10, 2009) (“*Gould*”), held that the Cayuga Indian Nation could sell untaxed cigarettes to non-Indians from convenience stores located in Union Springs and Seneca Falls. In contrast, the United States District Court for the Eastern District of New York, in *City of New York v. Golden Feather Smoke Shop, Inc.*, 2009 U.S. Dist. LEXIS 76306 (E.D.N.Y. 2009) (“*City of New York*”), granted the City of New York a preliminary injunction enjoining various smoke shops on the Poospatuck Reservation in eastern Long Island from selling untaxed cigarettes to non-Indians.

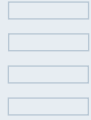
The two different results were based on the courts’ different interpretations of New York law, specifically Section 471 and 471-e of the N.Y. Tax Law. Section 471 is the general provision for the taxation of cigarettes in New York and imposes a tax on “all cigarettes possessed in the state by any person for sale, except that no tax shall be imposed on cigarettes sold under such circumstances that [the] state is without power to impose such tax . . .” N.Y. Tax Law § 417(1). Section 471-e, enacted in 2005, was the New York Legislature’s most recent attempt to prod the State into collecting taxes on the sale of cigarettes by Indian businesses to non-Indians and required the Department of Taxation and Finance (“DTF”) to develop a coupon system that would be used to allow Indian retailers to procure a certain amount of non-taxed cigarettes for sale to Indians. When the DTF failed to enact the coupon system by the deadline set forth in the statute, the statute was held to be ineffective. See *Day Wholesale, Inc. v. State of New York*, 51 A.D.3d 383, 856 N.Y.S.2d 808 (4th Dep’t 2008) (“*Day Wholesale*”).

In *Gould*, the Sheriffs of Cayuga County and Seneca County obtained and executed search warrants allowing them to seize untaxed cigarettes from two convenience stores owned by the Cayuga Indian Nation. The Nation filed an Order to Show Cause seeking return of the seized cigarettes arguing that the sale of the cigarettes occurred on a “qualified reservation,” as that term was defined by the tax law, and that, because of the holding in *Day Wholesale*, there was no obligation to collect any tax on sales to non-Indians. Therefore, the Nation argued, the sale of untaxed cigarettes to non-Indians did not violate the New York Tax Law. The Supreme Court denied the Nation’s application holding that the sale of the cigarettes to non-Indians was subject to sales tax pursuant to the provisions of Section 471 of the Tax Law. The Supreme Court also held that the stores involved were not located on a “qualified reservation.” The Nation appealed to the Fourth Department.

The Fourth Department reversed, holding that the now-defunct Section 471-e of the Tax Law represented the sole means by which the sale of cigarettes by Indian businesses to

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non-Indians could be taxed. The majority found that the Legislature, by enacting Section 471-e, intended to “overhaul the statutory scheme” found in Section 471 and that Section 471-e was the sole statutory basis for the taxation of cigarettes by Indian businesses to non-Indians. Because the court had invalidated Section 471-e in *Day Wholesale*, the possession or sale of untaxed cigarettes on qualified reservations could not subject the seller or possessor to criminal prosecution. The Fourth Department then went on to hold that the stores in question were on a “qualified reservation” as that term was defined by the Section 470(16) of the Tax Law and reversed the decision of the Supreme Court¹.

The City of New York took a different approach. The City filed an action in federal court under the Contraband Cigarette Trafficking Act, 18 U.S.C. § 2341 *et seq.* (the “CCTA”) and the Cigarette Marketing Standards Act, N.Y. Tax Law § 483 *et seq.* (the “CMTA”), seeking a preliminary injunction prohibiting the sale of untaxed cigarettes to non-Indians by Indian-owned retailers on the Poospatuck Reservation in eastern Long Island². The City presented evidence that millions of cartons of untaxed cigarettes purchased from the defendant retailers made their way to New York City and were sold on the city streets at a considerable discount. The City also presented evidence that the lower cost of the bootleg cigarettes resulted in higher rates of smoking and the concomitant increase in lung cancer.

The defendant retailers, argued, among things, that they did not violate the statutes because, based on the Fourth Department’s decision in *Gould*, the cigarettes were not taxable under New York law, an essential element under both statutes. The District Court acknowledged the majority’s holding in *Gould*, but then held that, in its opinion, the New York Court of Appeals would not agree with that holding and would, instead, agree with Justice Peradotto’s dissent in *Gould* that argued that Section 471-e did not supplant the tax obligation created by Section 471, but was merely an attempt to create a method to collect the taxes imposed by Section 471. Both Justice Peradotto and the District Court found that the clear language of Section 471 created a tax on the sale of cigarettes by Indian businesses to non-Indians and that there was no indication that Section 471-e was meant to revoke that tax. Both opinions relied on the fact that DTF itself characterized Section 471-e and its predecessor sections as “methods to collect the tax,” not creating the tax itself. Absent any express revocation of the tax liability created by Section 471, the cigarettes owned by the Defendants in the *City of New York* case were subject to New York tax and the sale of those cigarettes to parties who then took them to New York City to sell at a discount violated both the CCTA and the CMTA. The District Court issued an injunction prohibiting such sales.

The issue of the interplay between Section 471 and Section 471-e of the N. Y. Tax Law will have to be decided by the New York Court of Appeals. Cayuga and Seneca Counties, in *Gould*, have moved for leave to appeal to the New York Court of Appeals. The District Court, in *City of New York*, stayed enforcement of the injunction to allow the defendant retailers to appeal the decision to the United States Court of Appeals for the Second Circuit. That court has the ability to refer questions of unsettled state law to the New York Court of Appeals. By either route, the New York Court of Appeals will have to decide whether, as held by the Fourth Department, Section 471-e is the sole source of taxing authority over the sale of untaxed cigarettes by Indian businesses to non-Indians or whether Section 471 creates an obligation to tax those sales. That determination will have a substantial impact on the sale of such cigarettes in the future. ■

¹ There are substantial grounds to argue that the Fourth Department’s holding that the stores were on a “qualified reservation” was incorrect but that debate is beyond the scope of this alert.

² The defendants argued that, as Indian owned enterprises, they were entitled to tribal sovereign immunity. The court rejected that argument holding that the retailers were private entities, not an arm of the tribe. This defense was not raised by the Cayuga Indian Nation in *Gould*.

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