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SUPREME COURT HOLDS THAT FEDERAL COURTS

MAY ENJOIN ENFORCEMENT OF COLORADO’S

2010 SALES AND USE TAX NOTIFICATION LAW

(AND JUSTICE KENNEDY STIRS THE POT)

In our 2011, Issue 1, *Washington Quarterly Review*, we reported that Colorado had enacted a law that would have required out-of-state retailers who do not collect the state’s sales and use tax to (1) notify each Colorado purchaser on its invoice that sales or use tax is due to the state and that Colorado law requires the customer to file a sale or use tax return, (2) send a notice mailed by first class mail to all Colorado purchasers by January 31 each year stating that Colorado law requires the purchasers to file a sale or use tax return and showing such information as the Colorado Department of Revenue shall require regarding their purchases, including an annual statement of purchases made the previous year for which tax was not collected, and, if available, the dates of purchase, the amounts of each purchase, and the category of the purchase, including whether the purchase is exempt from the sale or use tax, and (3) provide to the Colorado Department of Revenue, the names, addresses, and purchase amounts of all Colorado customers for whom tax was not collected by March 1 of each year.

The Colorado law was codified as codified as Colo. Rev. Stat. § 39-21-112(3.5), and it was a clever attempt to circumvent the Supreme Court’s decisions in *Quill v. North Dakota*, 504 U.S. 298 (1992). Based on prior precedent, *National Bellas Hess v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), the Supreme Court held in *Quill* that an out-of-state seller had to have substantial physical presence in a state before it could be required to collect and remit that state’s sales and use tax.

On January 26, 2011, a federal district court issued a preliminary injunction prohibiting Colorado from enforcing its new law on the grounds that the law discriminated against out-of-state businesses and imposed an undue burden on interstate commerce. In reaching its conclusion, the court held that the Direct Marketing Association (DMA) showed a substantial likelihood that it would succeed in proving that the Colorado law and the regulations promulgated pursuant to it were discriminatory because “in practical effect, they impose a burden on interstate commerce that is not imposed on in-state commerce.” It agreed that the DMA had demonstrated a substantial likelihood of success on the merits of its discrimination claim, because the state had nondiscriminatory alternatives at its disposal, such as collecting its use tax directly from Colorado taxpayers. In addition, the court ruled that the burdens the Colorado statute and regulations imposed were inextricably related in kind and purpose to the burdens condemned in Quill and that “The Act and the Regulations impose these burdens on out-of-state retailers who have no connection with Colorado customers other than by common carrier or the United States mail. Those retailers likely are protected from such burdens on interstate commerce by the safe-harbor established in Quill.” The Colorado law and regulations impose burdens on out-of-state retailers that have no connection with Colorado customers other than by common carrier, and, as such, the restrictions would likely be held to be an undue burden under the commerce clause.

On March 30, 2012, the district court struck down the Colorado statute under the commerce clause, in *Direct Marketing Association v. Huber*, No. 10-cv-01546-REB-CBS (D. Colo. Mar. 30, 2012). It held that the act and regulations were discriminatory because “in practical effect, they impose a burden on interstate commerce that is not imposed on in-state commerce.” In addition, the court concluded that burdens imposed by the Colorado statute and regulations were inextricably related in kind and purpose to the burdens condemned in *Quill* and that “The Act and the Regulations impose these burdens on out-of-state retailers who have no connection with Colorado customers other than by common carrier or the United States mail. Those retailers likely are protected from such burdens on interstate commerce by the safe-harbor established in *Quill*.” (<http://www.journalofaccountancy.com/content/dam/jofa/archive/issues/2012/04/directmktgvcolo.pdf> (visited Mar. 2, 2015)). The made its preliminary injunction permanent.

As a result of the holding that the law was unconstitutional and the permanent injunction that prohibited its enforcement, Colorado has been unable to force out-of-state retailers to provide the notices and gather the information its statute would have required, or collect and remit the use tax to the state. The court’s ruling that the Colorado law and regulations discriminate against interstate commerce and impose an undue burden on out-of-state retailers with no connection to Colorado other than by common carrier or U.S. mail seemed to be on solid footing.

Then, rather unexpectedly, the U.S. Court of Appeals for the Tenth Circuit reversed the holding of the lower court in *Direct Marketing Association v. Brohl*, 735 F.3d 904 (10th Cir. 2013), on the grounds that the federal Tax Injunction Act (TIA), 28 U.S.C. § 1341, precluded federal jurisdiction over the DMA’s claims. The TIA states that “district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.” The Tenth Circuit reviewed its precedent and concluded that the DMA was indeed asking federal courts to enjoin the assessment or collection of a tax, and that the DMA had ample remedies available to it in Colorado’s state courts. Accordingly, the appeals court remanded the case to the lower court with instructions to dissolve the injunction.

Although the Tenth Circuit reversed the district court on the grounds that it lacked jurisdiction to hear the case, its ruling was not the end of the battle over the Colorado law. The DMA took the advice of the federal appeals court and immediately filed suit in state court asking that the Colorado law be struck down. On February 18, 2014, a Colorado state court issued a preliminary injunction once again prohibiting the imposition of the state’s reporting requirements. In so doing, the court made an initial determination that Colorado’s notification requirements discriminated against out-of-state businesses. *Direct Marketing Association v. Department of Revenue*, No. 13CV34855 (Colo. Dist. Ct. Feb. 18, 2014). The state court litigation is proceeding without regard to the federal litigation.

While the parties were litigating the validity of the law in Colorado state court, the U.S. Supreme Court reversed the Tenth Circuit’s decision regarding the scope and applicability of the TIA in *Direct Marketing Association v. Brohl*. The court held that the plain language of the TIA prohibits only injunctions that involve “the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.” The Colorado statute imposes notice and reporting requirements; it does not involve the assessment, levy, or collection of a state tax. Therefore, the TIA cannot apply.

The holding of the Supreme Court in *Brohl* was very narrow in that it only addressed the breadth of the TIA. The court did not reach the merits of the Colorado statute, because it was not required to do so. As a result, it sent the case back to the appeals court so that it could consider the merits of the district court’s decision. *Direct Marketing Association v. Brohl*, No. 13-1032 (U.S. Sup. Ct. Mar. 3, 2015) is available at <http://www.supremecourt.gov/opinions/14pdf/13-1032_8759.pdf> (visited Mar. 12, 2015).

The Supreme Court’s decision in *Brohl* would have been a straightforward and unremarkable interpretation of a federal statute if it had not been for the concurring opinion of Justice Kennedy. He starts by writing that the opinion of the court has his “unqualified join and assent, for in my view it is complete and correct,” and then goes on to add that it is time for the court to reconsider and overturn its decisions in *Quill* and *National Bellas Hess*. While *National Bellas Hess* may not necessarily have been wrongly decided in 1967, the Supreme Court was analyzing commerce clause cases differently in 1992 when it decided *Quill*. The court nonetheless reaffirmed *National Bellas Hess* in 1992 solely because it was existing precedent.

On a more practical level, Justice Kennedy notes that the national marketplace had changed considerably since the court decided *Quill* in 1992, with the Internet and electronic commerce as the main drivers of this change. For example, mail order sales were estimated to be $180 million in 1992, but they had reached about $3.16 trillion in 2008. He states that “Given these changes in technology and consumer so­phistication, it is unwise to delay any longer a reconsider­ation of the Court’s holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier.”

Due to the increasing importance of electronic commerce, there is a strong argument that a retailer conducting extensive business in a state has sufficient nexus with that state to be required to collect and remit that state’s sales and use tax, even if the retailer conducts that business remotely only (*i.e.*, without physical presence). Therefore, Justice Kennedy concludes that the holding in *Quill* should be left in place only if there is a compelling showing that its rationale is still correct. After reading Justice Kennedy’s concurrence, it seems likely that in the fairly near future out-of-state sellers will be required to collect and remit state sales and use tax everywhere they do business regardless whether they have any physical presence. If Congress does not require all retailers to collect and remit sales and use taxes by enacting the Marketplace Fairness Act or other similar legislation this year, then the Supreme Court may undertake to impose that requirement as soon as the opportunity presents itself.