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FEDERAL APPEALS COURT UPHOLDS COLORADO SALES TAX REPORTING LAW

In our 2011, Issue 1, *Washington Quarterly Review*, we reported that a federal district court had issued a preliminary injunction prohibiting Colorado from enforcing a sales and use tax reporting statute it had enacted in March 2010. Colorado's new law, H.B. 1193, required out-of-state retailers that make sales to Colorado residents without collecting and remitting sales tax to the state to provide certain notices and to gather information that they would have to report to the state. Alternatively, out-of-state retailers could collect and remit the use tax to the state.

Colorado H.B. 1193 added new subsection Colo. Rev. Stat. § 39-21-112(3.5), and it 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 [Colo. Rev. Stat. § 39-21-112(3.5)(c)], (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 [Colo. Rev. Stat. § 39-21-112(3.5)(d)(I)], 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 [Colo. Rev. Stat. § 39-21-112(3.5)(d)(II)].

The Colorado law was a clever attempt to circumvent the Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which requires an out-of-state seller to have substantial physical presence in a state before it could be made to collect and remit that state's sales and use tax. Unlike state laws that sought to broaden the meaning of substantial physical presence without running afoul of the *Quill* case, the Colorado statute took a more indirect and ingenious approach. Yet, until now, even this approach was unavailing.

Shortly after the state enacted H.B. 1193, the Direct Marketing Association sued in federal district court arguing that the law was unconstitutional. On January 26, 2011, in *Direct Marketing Association v. Huber*, No. 10-cv-01546-REB-CBS (D. Colo. Jan. 26, 2011), the federal court issued a preliminary injunction prohibiting Colorado from enforcing H.B. 1193 on the grounds that the law discriminated against out-of-state businesses and imposed an undue burden on interstate commerce. As a result, the court issued a preliminary injunction preventing the state from enforcing the statute. 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 appeared to be on solid footing

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.

Then, on August 20, 2013, the U.S. Court of Appeals for the Tenth Circuit held, inexplicably, that federal courts did not have jurisdiction over the DMA's suit under the Tax Injunction Act (TIA). *Direct Marketing Association v. Brohl*, 735 F.3d 904 (10th Cir. 2013). As a result, it remanded the case to dissolve the permanent injunction and to dismiss the DMA's suit. The lack of subject matter jurisdiction meant that the Court of Appeals did not reach the merits of the DMA's claims, including the constitutional challenges.

The U.S. Supreme Court granted cert on July 1, 2014, and on March 3, 2015 it held unanimously that the TIA did not prevent the DMA from challenging Colorado's sales use tax reporting statute in federal court. Therefore, it remanded the case to the Tenth Circuit to consider the merits of the DMA's challenge to the Colorado law. *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015). On remand, the court of appeals held on February 22, 2016 that Colorado's sales and use tax reporting law did not violate the dormant commerce clause because it neither unduly burdened nor discriminated against interstate commerce. *Direct Marketing Association v. Brohl*, No. 12-1175 (10th Cir. Feb. 22, 2016). (The case can be found on the Tenth Circuit's web site, https://www.ca10.uscourts.gov/opinion/search)

The appeals court read *Quill* very narrowly to apply solely to the duty to collect and remit sales and use taxes, rejecting the DMA's argument that *Quill* also applied more broadly as well to cases that did not involve an obligation to collect taxes. Therefore, it reasoned that because physical presence is not required before an out-of-state retailer can be obligated to collect and report sales and use tax information, the Colorado law cannot possibly impose an undue burden on interstate commerce. The court also held that Colorado's law did not discriminate against interstate commerce because it did not treat retailers differently based on geographical distinctions; it only distinguished between retailers who collected sales and use tax and those that did not. Moreover, it held that the DMA did not show that the burden on out-of-state retailers was higher than on in-state ones. While in-state retailers did not have to comply with the new reporting rules, they had their own regulatory burdens (for example, obtaining a sales tax license and collecting and paying the sales tax due). Through this specious analysis, the court was able to magically ignore the inconvenient fact that the statute was discriminatory because it applied to out-of-state retailers only, as they were the only ones who did not collect and remit Colorado's sales and use tax. Regardless how one may analyze the matter, it would seem that the Colorado sales and use tax reporting statute discriminates against interstate commerce.

The DMA has no good options at this point. It can appeal the case to the supreme court, but that approach carries many substantial risks. First, the court may decline to hear the case. Even if the high court were to accept a petition for review, however, the ultimate outcome would be uncertain. While it is possible that the court might reverse the Tenth Circuit's dubious holding, it is equally possible that the court may use this case to reconsider *Quill* itself, which Justice Kennedy views as obsolete. Indeed, in his concurring opinion in the earlier appeal holding that the TIA did not apply to the Colorado statute, he wrote, "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." *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124, 1134-35 (2015) (Kennedy, J., concurring).

On the other hand, allowing the decision in *Brohl* to stand without any further challenge also carries some risk. Other states may be emboldened by the Tenth Circuit's decision and enact their own sales and use tax reporting laws. If such laws are onerous enough, out-of-state retailers may decide it is cheaper and more efficient to collect sales and use taxes instead of complying with reporting requirements. For now, there are more questions than there are answers as we slowly move ever closer to a time when all out-of-state retailers will be required to collect and remit sales and use taxes.