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SUBJECT

UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT UPHOLDS COLORADO'S SALES AND USE TAX CUSTOMER NOTICE AND REPORTING REQUIREMENT ON REMOTE SELLERS

SUMMARY

In *Direct Marketing Ass'n v. Brohl*, No. 12-1175 (filed Feb. 22, 2016), the United States Court of Appeals for the Tenth Circuit upheld Colorado's sales and use tax customer notice and reporting requirement on remote sellers who are otherwise protected from a sales/use tax collection obligation on their sales to Colorado customers based on their lack of a physical presence in the state.

DETAILS

The Supreme Court of the United States in *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), held that a state cannot impose a sales or use tax collection obligation on an out-of-state seller if that seller lacks a physical presence in the state. Since then, states have resorted to a number of tactics to assert taxing jurisdiction over Internet, mail order, and other remote sellers. For example, in 2010 Colorado enacted a law that imposes notice and reporting obligations on retailers that do not collect sales tax on their sales to Colorado customers. Specifically, the law requires non-collecting retailers to: (1) send a notice to Colorado customers that their purchases may be subject to use tax, (2) send customers an annual purchase summary if their aggregate purchases exceed $500, and (3) provide a "customer information report to the Colorado Department of Revenue of customer names, addresses, and total amount of purchases." The Direct Marketing Association ("DMA"), an industry group of businesses and organizations that market and sell products via catalogs, advertisements, broadcast media, and the Internet, challenged the law as discriminatory against and imposing an undue burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

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Soon after the Colorado law was enacted, the DMA challenged it in federal district court. The court granted summary judgment for the DMA in early 2012 and issued an injunction to permanently enjoin the Colorado Department of Revenue from enforcing the law on the grounds that it discriminated against and imposed an undue burden on interstate commerce. After Colorado appealed to the U.S. Court of Appeals for the Tenth Circuit, the Tenth Circuit held that the federal district court decision violated the Tax Injunction Act, ch. 646, 62 Stat. 932 (1948) (codified as 28 U.S.C. § 1341) ("TIA"), a federal law that prohibits federal courts from hearing state tax cases intended to enjoin the assessment, levy, or collection of any state tax unless state law does not provide a plain, speedy, and efficient remedy. Colorado then brought the case to the Supreme Court of the United States, which reversed the Tenth Circuit in *Direct Marketing Ass'n v. Brohl,* 575 U.S. ___, 135 S.Ct. 1124 (2015) (*Brohl I*). The Court held that the TIA did not bar federal courts from hearing a challenge to the Colorado law and remanded the case to the Tenth Circuit for further proceedings on the DMA's Commerce Clause challenges.

In *Direct Marketing Ass'n v. Brohl,* No. 12-1175 (Feb. 22, 2016) (*Brohl II*), the Tenth Circuit was persuaded by the U.S. Supreme Court's decision in *Brohl I* with respect to the import of *Quill*. According to the Court in *Brohl I*, the decision in *Quill* established the principle that a state "may not require retailers who lack a physical presence in the State to *collect* [sales and use] *taxes* on behalf of the [state]." Based on the U.S. Supreme Court's reasoning that the TIA was not implicated in *Brohl I* (i.e., the DMA's federal court action was not filed to enjoin the assessment, levy, or collection of a state tax, only notice and reporting requirements), the Tenth Circuit reasoned that *Quill* applies narrowly and only requires that there be a physical presence before a company can be compelled to collect a tax. As such, *Quill* is inapplicable when a company without a physical presence is subjected to procedural notice and reporting obligations. The Tenth Circuit's view of *Quill* is fundamental to that court of appeals' rejection of the DMA's Commerce Clause challenges with respect to the Colorado law.

A state tax law discriminates against interstate commerce in violation of the Commerce Clause if it facially discriminates against interstate commerce or if it has a discriminatory effect on interstate commerce. The Tenth Circuit held the Colorado law did not facially discriminate against interstate commerce, because it did not distinguish between in-state and out-of-state economic interests. Rather, any retailer was subject to the customer notice and reporting requirements if it did not collect Colorado sales and use taxes (e.g., "non-collecting retailers"). According to the Tenth Circuit, the Colorado law's application to any non-collecting retailer, and not specifically to out-of-state retailers without a Colorado physical presence, was key to the law withstanding the DMA's facial discrimination challenge. Some out-of-state retailers voluntarily collected Colorado sales and use taxes, while others did not. The court of appeal reasoned that the law distinguished on the basis of whether a retailer (in-state or out-of-state) collected Colorado sales and use taxes, not on the basis of any geographical distinctions between retailers.

Next, the Tenth Circuit held the Colorado law did not have a discriminatory effect on interstate commerce. First, according to the court, in-state retailers did not gain a competitive advantage, because Colorado consumers had pre-existing obligations to pay sales or use taxes on their purchases from in-state or out-of-state retailers. Second, the Tenth Circuit found that in-state and out-of-state retailers were not similarly situated because the out-of-state retailers without a physical presence in Colorado did not have to collect Colorado sales and use taxes, unlike their in-state competitors. Third, the Tenth Circuit reasoned that Colorado's customer notice and reporting requirements would have a discriminatory effect only if, in the broader context, they imposed different treatment on in-state and out-of-state retailers that benefited the former and burden the latter. The court found that the Colorado customer notice and reporting requirements imposed on out-of-state, non-collecting retailers was no more burdensome than in-state retailers' obligations to collect and remit sales and use taxes on their sales to Colorado customers. In short, the Tenth Circuit held that *Quill* only protects out-of-state retailers with no physical presence from sales and use tax collection.

After disposing of the DMA's interstate commerce discrimination challenge, the Tenth Circuit rejected the DMA's undue burden challenge. The DMA relied solely on *Quill* in arguing that the Colorado customer notice and reporting requirements unduly burdened interstate commerce. Since the court held that *Quill* is limited to sales and use tax collection, and a physical presence is not required before an out-of-state retailer can be subjected to non-tax regulatory requirements, the DMA's undue burden challenge failed.

BDO INSIGHTS

- Prior to *Brohl I* and *Brohl II*, other states had proposed similar customer notice and reporting requirements to those enacted by Colorado. The result in *Brohl II* could encourage other states to pursue similar legislation.
- The Tenth Circuit's view of *Quill's* physical presence requirement as limited not just to tax collection, but also narrowly to collection of sales and use taxes, could embolden more states to assert economic presence nexus with respect to income taxes, gross receipts taxes, and other non-sales/use taxes.
- Likewise, in *Brohl I*, Justice Kennedy filed a concurring opinion in which he remarked that *Quill's* physical presence requirement may have been surpassed by advancements in technology and Internet commerce and that "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*." As a result, *Brohl I* and *Brohl II* could have far-reaching consequences beyond notice and reporting of consumer's mail order and Internet purchases. Just as the Tenth Circuit seemed persuaded by Justice Kennedy's concurring opinion in *Brohl I*, these decisions could signal the end of a physical presence nexus requirement for all state taxes, with the exception of sales and use taxes.