10th Circuit upholds Colorado's remote seller reporting requirements

Overview

On February 22, 2016, the U.S. Court of Appeals for the Tenth Circuit (the 10th Circuit) issued its latest decision in *Direct Marketing Association v. Brohl*,[1] deciding in favor of the Colorado Department of Revenue (DOR) by reversing the U.S. District Court's determination that Colorado's remote seller reporting requirements violated the Commerce Clause of the U.S. Constitution. In reaching its decision, the 10th Circuit determined that the U.S. Supreme Court's holding in *Quill Corp. v. North Dakota*[2] was limited to sales and use tax collection and concluded that Colorado's remote seller reporting requirements do not discriminate against or unduly burden interstate commerce.[3]

This Tax Alert summarizes the procedural background in *Direct Marketing Association*, discusses the 10th Circuit's decision, and provides taxpayer considerations concerning the potential implications of the decision.

Background

In 2010, Colorado enacted Colo. Rev. Stat. § 39-21-112(3.5), establishing a reporting obligation for retailers that sell goods to customers in Colorado but do not collect or remit Colorado sales tax on those transactions. Direct Marketing Association (DMA), a trade association of businesses and organizations, filed suit in U.S. District Court, challenging Colo. Rev. Stat. § 39-21-112(3.5) and its accompanying regulations. On March 30, 2012, the federal district court granted DMA's motion for summary judgment and issued a permanent injunction enjoining the DOR from enforcing the sales tax notice and reporting obligations.[4] The federal district court held that Colorado's reporting requirements for non-collecting retailers discriminated against and placed undue burdens on interstate commerce, in violation of the dormant Commerce Clause of the U.S. Constitution.[5]

Subsequently, the DOR appealed the federal district court's ruling to the 10th Circuit. The 10th Circuit decided that under the Tax Injunction Act (TIA) (28 U.S.C. § 1341), the federal district court lacked jurisdiction to decide the matter and remanded the case with instructions to dissolve the permanent injunction.[6] After the 10th Circuit instructed the federal district court to dissolve the permanent injunction enjoining the DOR from enforcing the remote seller reporting law,[7] DMA filed suit in Colorado district court in the City and County of Denver. On February 18, 2014, the Colorado district court issued a preliminary injunction enjoining the DOR from enforcing the remote seller reporting law.[8]

DMA also petitioned the U.S. Supreme Court to issue a writ of certiorari. The Supreme Court granted certiorari. On July 10, 2014, the Colorado district court stayed all further proceedings of the DMA case pending resolution of the DMA's appeal to the U.S. Supreme Court.[9] On March 3, 2015, the Supreme Court issued a unanimous decision reversing the 10th Circuit's ruling. The Supreme Court held that the TIA does not bar DMA's suit because DMA's sought relief would not enjoin, suspend, or restrain the assessment, levy or collection of Colorado's sales and use taxes.[10] The Supreme Court remanded the case to the 10th Circuit to decide the merits of DMA's Commerce Clause claims.[11]

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[1] *Direct Mktg. Ass'n v. Brohl*, No. 12-1175 (10th Cir. Feb. 22, 2016), available here.
[2] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).
[3] *Direct Mktg. Ass'n v. Brohl*, No. 12-1175, at 9 (10th Cir. Feb. 22, 2016).
[4] *Direct Mktg. Ass'n v. Huber*, 2012 U.S. Dist. LEXIS 44468 (D. Colo. Mar. 30, 2012).
[5] *Id.*
[6] *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904 (10th Cir. Colo. 2013).
[7] *Id*.
[8] *Direct Mktg. Ass'n v. Colorado Department of Revenue,* District Court, City and County of Denver, State of Colorado, Case No. 2013CV34855, Feb. 18, 2014.
[9] *Direct Mktg. Ass'n v. Colorado Department of Revenue,* District Court, City and County of Denver, State of Colorado, Case No. 2013CV34855, *July 10, 2014.*
[10] The Tax Injunction Act provides that federal 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. 28 U.S.C. § 1341. *Direct Mktg. Ass'n V. Brohl*, 135 S. Ct. 1124, 1134 (2015).
[11] *Id.*

The 10th Circuit's opinion

Reversing the federal district court's decision, the 10th Circuit held that Colorado's remote seller reporting requirements do not violate the dormant Commerce Clause of the U.S. Constitution because they neither discriminate against nor unduly burden interstate commerce.[12] The 10th Circuit opinion may be separated into the following three distinct sections: (1) the scope of the bright-line physical presence rule recognized in *Quill*; (2) whether the remote seller reporting requirements discriminate against interstate commerce; and (3) whether the remote seller reporting requirements unduly burden interstate commerce. Each section is discussed in further detail below.

Narrow application of Quill

The 10th Circuit analyzed the scope of the U.S. Supreme Court's holding in *Quill*. In *Quill*, the U.S. Supreme Court affirmed the *Bellas Hess* bright-line physical presence standard for substantial nexus under the Commerce Clause, stating that "the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law."[13] The 10th Circuit explained that while *Quill's* bright-line physical presence test has not been overruled by the U.S. Supreme Court, the U.S. Supreme Court has also "not extended the physical presence rule beyond the realm of sales and use tax collection."[14] Because the 10th Circuit determined that *Quill* has a narrow application which does not extend beyond sales and use tax collection, the 10th Circuit concluded that *Quill's* physical presence standard is not applicable to Colorado's remote seller reporting requirements.[15]

No discrimination against interstate commerce

The 10th Circuit reviewed the federal district court's dormant Commerce Clause determination that Colorado's remote seller reporting requirements impermissibly discriminate against interstate commerce. The 10th Circuit first determined that the remote seller reporting requirements do not facially discriminate against interstate commerce. In analyzing the statutory language, the 10th Circuit concluded that the law provides differential treatment "between those retailers that collect Colorado sales and use tax and those that do not," as opposed to explicit geographical (in-state or out-of-state) distinctions.[16]

The 10th Circuit also examined in detail whether the remote seller reporting requirements are discriminatory in their direct effects. The 10th Circuit cited three principles as being instructive: (1) the U.S. Supreme Court has repeatedly indicated that differential treatment must adversely affect interstate commerce to the benefit of intrastate commerce to trigger dormant Commerce Clause concerns;[17] (2) equal treatment requires that those similarly situated be treated alike;[18] and (3) the U.S. Supreme Court has repeatedly stressed that laws are not to be understood in isolation, but in their broader context.[19]

In light of these principles, the 10th Circuit determined that the remote seller reporting requirements are not discriminatory in their direct effects because: (1) the Colorado reporting obligation does not give in-state retailers a competitive advantage;[20] (2) the non-collecting, out-of-state, retailers are not similarly situated to the in-state retailers;[21] and (3) the remote seller reporting requirements are designed to increase compliance with preexisting tax obligations and apply only to retailers that are not otherwise required to comply with the greater burden of tax collection and reporting.[22]

Based on the forgoing, the 10th Circuit concluded that DMA failed to provide evidence to establish that "the notice and reporting requirements for non-collecting out-of-state retailers are more burdensome than the regulatory requirements in-state retailers already face."[23] Thus, the 10th Circuit held that the remote seller reporting requirements do not discriminate in their direct effect.

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[12] *Direct Mktg. Ass'n v. Brohl*, No. 12-1175, at 35 (10th Cir. Feb. 22, 2016).
[13] *Quill*, 504 U.S. at 317.
[14] *Direct Mktg. Ass'n v. Brohl*, No. 12-1175, at 16 (10th Cir. Feb. 22, 2016).
[15] *Id*. at 18.
[16] *Id*. at 23.
[17] *Id*. at 25.
[18] *Id*. at 26.
[19] *Id*. at 27.
[20] *Id*. at 26.
[21] *Id*. at 27.
[22] *Id*. at 28.
[23] Id. at 31.

No undue burden on interstate commerce

The 10th Circuit also held that the Colorado remote seller reporting requirements do not impose an undue burden on interstate commerce. Unlike the federal district court, the 10th Circuit did not consider the conclusions in *Quill* to be controlling. The 10th Circuit reiterated that *Quill* is limited to the narrow context of sales and use tax collection. Relying on the U.S. Supreme Court's determination in *Direct Mktg. Ass'n v. Brohl* that Colorado's remote seller reporting requirements do not constitute a form of tax collection, the 10th Circuit concluded that *Quill* was not controlling relative to Colorado's remote seller reporting law.[24]

Next steps

We would expect the next step in the litigation to be for DMA to file a Petition for Rehearing en banc before the 10th Circuit. Meanwhile, the Colorado district court injunction remains in place.

Considerations

In *Direct Marketing Association v. Brohl*, Justice Kennedy issued a concurring opinion in which he strongly suggested that it was time for "a reconsideration of the [U.S. Supreme] Court's holding in *Quill*."[25] In closing his concurrence, Justice Kennedy called on the legal system to "find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess*."[26] Since Justice Kennedy's concurring opinion in *Direct Marketing Association v. Brohl* was issued, some states, such as Alabama[27] and South Dakota,[28] have adopted or proposed more broad sales and use tax nexus statutes, regulations, and administrative policies, which if challenged, may result in the "appropriate case for th[e] Court to reexamine *Quill* and *Bellas Hess*" as Kennedy suggested. No other justice joined Kennedy's concurring opinion.

Although the constitutional issues in *Quill* may be distinguished from those presented in *Direct Mktg. Ass'n v. Brohl*, the 10th Circuit's decision may have significant implications for the practical application of the *Bellas Hess* and *Quill* bright-line physical presence standard. Whatever the outcome of a Petition for Rehearing en banc before the 10th Circuit, the case may again be appealed to the U.S. Supreme Court. A petition for writ of certiorari will only be granted for compelling reasons,[29] and generally must be filed within 90 days after entry of a United States Court of Appeals judgment.[30] If the U.S. Supreme Court agreed to hear an appeal of the 10th Circuit's decision, a ruling could potentially have widespread implications such as reexamining the application of *Quill* or potentially defining the meaning of "substantial nexus" not only for sales and use taxes, but also for state income, franchise, and gross receipts taxes. If the Court denies *cert* or upholds the 10th Circuit's analysis that *Quill* is limited to sales and use tax collection, it could potentially lead to widespread adoption of reporting requirements similar to those enacted in Colorado by other states. The adoption of such requirements could certainly prompt remote sellers to examine whether it would be more efficient to collect and remit sales and use taxes, rather than comply with reporting requirements, rendering the practical application of *Quill's* bright-line physical presence standard much less meaningful.

Also, as noted by the 10th Circuit and the U.S. Supreme Court in *Quill*, "Congress holds the 'ultimate power' and is 'better qualified to resolve' the issue of 'whether, when, and to what extent the States may burden interstate [retailers] with a duty to collect [sales and] use taxes.'"[31] Several bills and discussion drafts that seek to require out-of-state retailers to collect sales and use tax have recently been introduced or otherwise contemplated in Congress.[32] While the likelihood of their passage is unknown, taxpayers should continue to monitor these federal legislative developments as a federal bill could be enacted that could definitively resolve the *Quill* and *Bellas Hess* debate.

Finally, if the Colorado DOR ultimately prevails in litigation and the injunction precluding the DOR from enforcing the remote seller reporting requirements is lifted, it is expected that the DOR will issue guidance regarding the timing of its enforcement of the remote seller reporting requirements. Retailers that may be subject to the requirements should continue to consider whether they are prepared to comply with the standards upon enforcement by the DOR. Due to the potential burden on retailers of complying with the reporting obligations,

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[24] *Id.* at 34.
[25] *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1135 (2015).
[26] *Id.*
[27] Ala. Admin. Code r. 810-6-2-.90.03 (effective for all transactions occurring on or after January 1, 2016).
[28] S.B. 106, 91st Legis. Assemb. (S.D. 2016).
[29] U.S. Sup. Ct. R. 10.
[30] U.S. Sup. Ct. R. 13.
[31] *Direct Mktg. Ass'n v. Brohl*, No. 12-1175, at 35 (10th Cir. Feb. 22, 2016), *quoting Quill*, 504 U.S. at 318.
[32] See, Marketplace Fairness Act of 2015 (S. 698); Online Simplification Act of 2015 (has not been introduced as of the date of this alert); Remote Transaction Parity Act (H.R. 2775).

which may require adding complex augmentations to sales and use tax systems, retailers may need to consider whether voluntary sales tax collection and remittance is a more compelling alternative then compliance with the reporting obligations.

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