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EXTERNAL ALERT

U.S. Supreme Court Issues Decision in Colorado Remote Seller Reporting Case

March 5, 2015

Overview

On March 3, 2015, the U.S. Supreme Court issued a unanimous decision for the petitioner in *Direct Marketing Association v. Brohl*, reversing the decision of the U.S. Court of Appeals for the Tenth Circuit (the "10th Circuit").[1] The 10th Circuit had held that the Tax Injunction Act ("TIA") (28 U.S.C. § 1341) deprived the U.S. District Court of jurisdiction to enjoin Colorado from enforcing its remote seller sales and use tax notice and reporting requirements.[2] In the Opinion of the U.S. Supreme Court, delivered by Justice Thomas, the Court held that the TIA does not bar the suit brought by the Direct Marketing Association ("DMA") because the relief sought would not enjoin, suspend, or restrain the assessment, levy or collection of Colorado's sales and use taxes.[3] The Court remanded the case to the 10th Circuit for further proceedings.[4]

Also, in a concurring opinion Justice Kennedy agreed in full with the Court's opinion but also emphasized that in light of the "far-reaching systemic and structural changes in the economy[,]"[5] "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*."[6] Justice Kennedy also suggested that the "legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess*."[7]

In this Tax Alert we summarize the Opinion of the Court and Justice Kennedy's Concurring Opinion. We also provide some taxpayer considerations.

Background

Colo. Rev. Stat. § 39-21-112(3.5) established a reporting obligation, effective March 1, 2010, on retailers that sell products to customers in Colorado but do not collect and remit Colorado sales or use tax on those transactions. DMA 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 District Court granted DMA's motion for summary judgment and issued a permanent injunction enjoining the Colorado Department of Revenue (the "DOR") from enforcing the sales tax notice and reporting obligations.[8] The District Court found that Colorado's reporting requirements for non-collecting retailers discriminated against and placed undue burdens on interstate commerce, in violation of the Commerce Clause of the United States Constitution.[9]

Subsequently, the DOR appealed the District Court's ruling to the 10th Circuit. The 10th Circuit decided that under the TIA the District Court lacked jurisdiction to decide the matter and remanded the case to the District Court with instructions to dissolve the permanent injunction.[10] DMA petitioned the U.S. Supreme Court to issue a writ of certiorari. The Court granted certiorari.[11]

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[1] *Direct Mktg. Ass'n v. Brohl*, No. 13-1032, slip op. at 13 (Thomas, J., opinion of the Court) (U.S. Mar. 3, 2015), *rev'g* 735 F.3d 904 (10th Cir. 2013).
[2] *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904.
[3] No. 13-1032, slip op. at 1, 13 (Thomas, J., opinion of the Court).
[4] *Id.* at 13.
[5] *Id.* at 3 (Kennedy, J., concurring).
[6] *Id.* As explained by Justice Kennedy, *Quill* is the U.S. Supreme Court case that reaffirmed the physical presence requirement for use tax nexus as established in *National Bellas Hess*. *See*, *id.* at 1 (Kennedy, J., concurring) (citing *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992); *National Bellas Hess, Inc v. Department of Revenue of Ill.*, 386 U.S. 753 (1967)).
[7] No. 13-1032, slip op at 4 (Kennedy, J., concurring).
[8] *Direct Mktg. Ass'n v. Huber*, 2012 U.S. Dist. LEXIS 44468 (D. Colo. Mar. 30, 2012).
[9] *Id.*
[10] *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904 (10th Cir. 2013).
[11] *Direct Mktg. Ass'n v. Brohl*, 134 S.Ct. 2901 (2014).

U.S. Supreme Court's Opinion

TIA Does Not Bar Suit to Enjoin Enforcement of Colorado's Remote Seller Notice and Reporting Requirements

The TIA 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 heard in the courts of such State."[12] The U.S. District Court previously issued a permanent injunction enjoining Colorado from enforcing its notice and reporting requirements.[13] Because an injunction is a form of equitable relief potentially barred by the TIA, the questions at issue before the Supreme Court were: (1) whether Colorado's enforcement of its remote seller notice and reporting requirements is an act of "assessment, levy or collection[;]" and (2) whether the relief sought by DMA would "restrain" Colorado's assessment, levy and collection of sales and use taxes.

Writing for the unanimous Court, Justice Thomas first concluded that Colorado's enforcement of its sales and use tax notice and reporting requirements does not encompass the "assessment, levy or collection" of sales and use taxes in Colorado.[14] As explained by Justice Thomas, although enforcement of the notice and reporting requirements may improve Colorado's ability to assess and collect sales and use taxes, the TIA "is not keyed to all activities that may improve a State's ability to assess and collect taxes. . . . [It] is keyed to the acts of assessment, levy and collection themselves, and enforcement of the notice and reporting requirements is none of these."[15] Allowing the TIA to apply to all activities that may improve a state's ability to assess and collect taxes "would be inconsistent not only with the text of the [TIA] statute, but also with our rule favoring clear boundaries in the interpretation of jurisdictional statutes."[16]

As expressed in the Opinion of the Court delivered by Justice Thomas, the Court next concluded that the relief sought by DMA would not restrain Colorado's assessment, levy and collection of taxes.[17] The Court specifically rejected the broad definition of the term "restrain" used by the 10th Circuit, which had concluded that the TIA bars any suit that would "limit, restrict, or hold back" the assessment, levy, or collection of state taxes.[18] In determining that the term "restrain" should not be defined so broadly by the 10th Circuit, the Court provided that the term has a more narrow meaning that "captures only those orders that stop (or perhaps compel) acts of 'assessment, levy or collection.'"[19] The Court set forth several reasons why the term "restrain" should be narrowly defined:

1. The statutory context suggests that the TIA uses the word "restrain" narrowly.[20] The words "enjoin" and "suspend" are terms of art in equity referring to "different equitable remedies that restrict or stop official action to varying degrees, strongly suggesting that 'restrain' does the same."[21]

2. As used in the TIA, "restrain" acts on a carefully selected list of technical terms, "assessment," "levy" and "collection," instead of acting on an all-encompassing term such as "taxation."[22] To give "restrain" a broader meaning would defeat the precision of that list, as virtually any court action related to any phase of taxation might be said to "hold back" collection.[23]

3. The TIA is rooted in equity practice, and courts of equity do not refuse to hear every suit that would have a negative impact on state tax revenues.[24] To interpret the term "restrain" broadly would result in the TIA barring every suit that has a negative impact on state tax revenues, supporting the conclusion that Congress used the term "restrain" in the narrower, equitable sense.[25]

[12] 28 U.S.C. § 1341.
[13] 2012 U.S. Dist. LEXIS 44468.
[14] *Direct Mktg. Ass'n v. Brohl*, No. 13-1032, slip op. at 9 (Thomas, J., opinion of the Court) (U.S. Mar. 3, 2015).
[15] *Id.*
[16] *Id.*
[17] *Id.* at 12.
[18] *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904, 913 (10th Cir. 2013).
[19] No. 13-1032, slip op. at 10 (Thomas, J., opinion of the Court).
[20] *Id.* at 10-11.
[21] *Id.* at 11.
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.* at 11-12.

4. Finally, adopting a narrower definition of “restrain” is consistent with the rule that “jurisdictional rules should be clear.”[26]

Applying the Court’s more narrow definition of the term “restrain,” a suit does not “restrain” the assessment, levy or collection of a state tax if it merely inhibits those activities.[27] Based on the foregoing, the Court concluded that the TIA does not bar the DMA’s suit in federal court.[28]

Court Highlighted, but Did Not Take a Position on, the Comity Doctrine

The Court did not take a position on whether DMA’s suit is barred by the “comity doctrine.”[29] The comity doctrine “counsels lower federal courts to resist engagement in certain cases falling within their jurisdiction.”[30] Under the doctrine, federal courts “refrain from interfering with the fiscal operations of state government in all cases where the Federal rights of the persons could otherwise be preserved unimpaired.”[31] The DOR did not seek comity in either of the lower courts, but the 10th Circuit, in a footnote to its opinion, stated that “the doctrine of comity also militates in favor of dismissal.”[32] On remand, the 10th Circuit may decide whether the comity argument remains available to the DOR.[33]

Justice Kennedy’s Concurring Opinion

In his concurring opinion, Justice Kennedy expressed his agreement with the Opinion of the Court and then addressed “what may well be a serious, continuing injustice faced by Colorado and many other States” with respect to a state’s inability to require a business to collect sales and use taxes when the business does not have physical presence in the state.[34] In explaining his concern, Justice Kennedy provided a brief overview of the Court’s decisions in this area, beginning with *Quill Corp. v. North Dakota*.[35] In *Quill* the Court reaffirmed the physical presence requirement established in *National Bellas Hess, Inc. v. Department of Revenue of Illinois.*[36] Although *Quill* reaffirmed *Bellas Hess*, in reaching its decision, the *Quill* majority acknowledged that but for *stare decisis*, “contemporary Commerce Clause jurisprudence might not dictate the same result” as that rendered in *Bellas Hess* given the Court’s more recent and refined test elaborated in *Complete Auto Transit, Inc. v. Brady*.[37] According to Justice Kennedy, “the *Quill* majority acknowledged the prospect that its conclusion was wrong when the case was decided.”[38]

Justice Kennedy stated further that the *Quill* holding is “inflicting extreme harm and unfairness on the States” as they are unable to collect much of the taxes on purchases from out-of-state retailers.[39] Specifically, he noted that California estimates that it collects only 4% of the use taxes due in respect to sales from out-of-state vendors.[40] According to Justice Kennedy, the Internet has caused “far-reaching systemic and structural changes in the economy” and, “[a]s a result, a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term.”[41] Given these changes, Justice Kennedy stated: “it is unwise to delay any longer a reconsideration of the Court’s holding in *Quill*[,] . . . [a] case questionable even when decided . . . . [Accordingly, t]he legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess.*”[42]

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[26] *Id.* at 12.
[27] *Id.* at 12.
[28] *Id.*
[29] *Id.* at 13.
[30] *Id.*
[31] *Id.*
[32] *Direct Mktg. Ass’n v. Brohl*, 735 F.3d 904, 920 n. 11 (10th Cir. 2013).
[33] No. 13-1032, slip op. at 13 (Thomas, J., opinion of the Court).
[34] *Id.* at 1 (Kennedy, J., concurring).
[35] *Id.* at 1 (citing *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).
[36] No. 13-1032, slip op. at 1 (Kennedy, J., concurring) (citing *Quill*, 504 U.S. at 311; *National Bellas Hess, Inc v. Dep’t of Revenue of Ill.*, 386 U.S. 753 (1967)).
[37] No. 13-1032, slip op. at 1-2 (Kennedy, J., concurring) (citing *Quill*, 504 U.S. at 311; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)).
[38] No. 13-1032, slip op. at 2 (Kennedy, J., concurring).
[39] *Id.* at 2.
[40] *Id.* at 2-3.
[41] *Id.* at 3.
[42] *Id.* at 3-4.

Considerations

The U.S. Supreme Court remanded the case to the 10th Circuit for further proceedings.[43] The 10th Circuit may now rule on the merits of the DOR's appeal regarding whether the remote seller reporting law violates the Commerce Clause, but the 10th Circuit may also first consider whether the doctrine of comity argument remains available to the DOR to potentially dismiss DMA's suit from federal court.

While we await further proceedings in this case, remote sellers subject to Colorado's notice and reporting requirements may wish to consider the following:

- As noted previously, prior to the 10th Circuit's holding that under the TIA the U.S. District Court lacked jurisdiction to hear DMA's suit, the District Court had held that the notice and reporting requirements violated the U.S. Commerce Clause.[44]
- After the 10th Circuit instructed the U.S. District Court to dissolve the permanent injunction enjoining the DOR from enforcing the remote seller reporting law,[45] DMA filed suit at the state level 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.[46] 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.[47] It is unclear how the Colorado District Court case will proceed following the U.S. Supreme Court's decision.
- DMA may seek restoration of its prior permanent injunction issued by the U.S. District Court enjoining the DOR from enforcing the remote seller reporting law, pending the 10th Circuit's ruling on the merits of the DOR's appeal. This permanent injunction was granted by the U.S. District Court and vacated following the 10th Circuit's ruling that under the TIA the District Court lacked jurisdiction to decide the suit.
- Justice Kennedy's Concurring Opinion questions the holdings in *Quill* and *Bellas Hess* in view of the "far-reaching systemic and structural changes in the economy" caused by the Internet since the time of these earlier rulings by the Court[48] and urges the Court to reconsider the holdings in *Quill* and *Bellas Hess* in the near future.[49] If the Supreme Court agrees to reexamine its holdings in *Quill* and *Bellas Hess*, such a reexamination could potentially have widespread implications regarding the meaning of substantial nexus not only for sales and use taxes, but also for state income, franchise, and gross receipts taxes.

Contacts

If you have questions regarding this U.S. Supreme Court decision or pertaining to other Colorado tax matters, please contact any of the following Deloitte Tax professionals.

Dwayne Van Wieren
Partner
Deloitte Tax LLP, Los Angeles
dvanwieren@deloitte.com
(213) 593-3734

Gregory McClure
Director
Deloitte Tax LLP, Denver
grmcclure@deloitte.com
(303) 312-4081

Lance Williams
Director
Deloitte Tax LLP, Denver
lancwilliams@deloitte.com
(303) 312-4119

Jeffrey Maxwell
Manager
Deloitte Tax LLP, Denver
jemaxwell@deloitte.com
(303) 312-4784

The authors of this Tax Alert would like to acknowledge the contributions of Laura Bath and Eric Schaefer to the drafting process. Laura is a Senior and Eric is a Consultant II. Both work in the Denver Multistate Tax Practice of Deloitte Tax LLP.

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[43] *Id.* at 13 (Thomas, J., opinion of the Court).
[44] *Direct Mktg. Ass'n v. Huber*, 2012 U.S. Dist. LEXIS 44468 (D. Colo. Mar. 30, 2012).
[45] *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904 (10th Cir. Colo. 2013).
[46] *Direct Mktg. Ass'n v. Colo. Dep't of Revenue,* Case No. 2013CV34855 (Colo. Dist. Ct. Feb. 18, 2014).
[47] *Direct Mktg. Ass'n v. Colo. Dep't of Revenue,* Case No. 2013CV34855 (Colo. Dist. Ct. Jul. 10, 2014).
[48] No. 13-1032 slip op. at 2-3 (Kennedy, J., concurring).
[49] *Id.* at 3-4.

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