Insights: Alerts

Tenth Circuit Rules Colorado Can Require Remote Retailers to Notify Customers of the States Use Tax

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On Monday, the U.S. Court of Appeals for the Tenth Circuit upheld the constitutionality of a Colorado law that requires remote retailers to notify customers of the state's use tax requirements and report certain customer tax information to the Colorado Department of Revenue. The Tenth Circuit's decision was issued in *Direct Marketing Association v. Brohl*, 2016 BL 49528, 10th Cir., No. 12-1175, 2/22/16. The ruling will likely embolden taxing authorities in other states. Taxpayers should expect other states to propose similar "notice and reporting" laws to address the so-called "remote sales tax collection problem."

Before discussing the Tenth Circuit's decision in *Direct Marketing Association*, it is important to note the backdrop against which the law at issue was enacted. Much ink has been spilt on the U.S. Supreme Court's decision in *Quill Corp v. North Dakota*, 504 U.S. 298 (1992), and the perceived barrier it creates to states' ability to collect billions in sales taxes from remote sales. In *Quill*, the Supreme Court held that, under the dormant Commerce Clause, a company must have a physical presence in a state before the company can be required to collect and remit sales tax on the sales it makes there. In an attempt to work around the "remote sales tax collection problem" created by *Quill*, Colorado turned to the state's complementary use tax. In 2010, Colorado passed a notice and reporting law, which requires remote retailers that do not collect Colorado sales tax to do three things: (1) send a "transactional notice" to purchasers informing them that they may be subject to Colorado's use tax; (2) send certain purchasers an "annual purchase summary" with the dates, categories, and amounts of their purchases, reminding them of their obligation to pay use taxes on such purchases; and (3) send the Colorado Department of Revenue an annual "customer information report", listing customers' names, addresses, and amounts spent.

Direct Marketing Association ("DMA"), a group of businesses and organizations that market and sell products remotely, challenged the Colorado law in federal district court as violating the dormant Commerce Clause. Among other things, DMA argued that the law unconstitutionally discriminated against and unduly burdened interstate commerce. The Tenth Circuit initially held that it lacked jurisdiction to hear DMA's challenge to the Colorado law under the Tax Injunction Act ("TIA"). In March 2015, the U.S. Supreme Court cleared the way for the Tenth Circuit's ruling on Monday when the Supreme Court held that the TIA did not strip federal courts of jurisdiction to hear the DMA's case.

Turning to the substance of the Tenth Circuit's decision, in determining whether the Colorado law violated the dormant Commerce Clause, the Tenth Circuit first analyzed whether the law violated the bright-line physical presence requirement imposed by *Quill* and then examined whether the law discriminated against or unduly burdened interstate commerce. With respect to *Quill*, the Tenth Circuit construed the scope of the case very narrowly. It first noted that the *Quill* physical presence requirement is limited to the realm of sales and use tax. It then

concluded that "*Quill* applies narrowly to and has not been extended beyond tax collection." According to the Tenth Circuit, the *Quill* physical presence requirement did not apply to the Colorado law because it imposed notice and reporting requirements and not collection requirements. Ironically, in ruling that the TIA did not prevent the Tenth Circuit from hearing DMA's challenge, the Supreme Court held that the TIA did not apply because the Colorado law did not enjoin, suspend or restrain the assessment, levy or collection of any tax under state law. The Supreme Court held that the law concerned only notice and reporting and not tax collection.

With respect to whether the Colorado law impermissibly discriminated against and unduly burdened interstate commerce, the Tenth Circuit held that the law did neither. According to the court, the law did not discriminate—either on its face or in its practical effects—against out-of-state retailers and, therefore, interstate commerce. The court emphasized that the language in the Colorado law refers only to "any retailer that does not collect Colorado sales tax." That text distinguishes between those entities that collect Colorado sales tax and those that do not; it did not distinguish between in-state and out-of-state retailers. Since the Colorado law did not explicitly make a geographical distinction between similarly situated entities, it did not facially discriminate. In assessing whether the law was discriminatory in its effects, the court concluded that the law did not favor in-state economic interests over out-of-state interests. The court ruled that the notice and reporting obligations imposed under the law on non-collecting out-of-state retailers were not more burdensome than the collection and reporting requirements already imposed on in-state retailers. Finally, with regard to whether the Colorado law unduly burdened interstate commerce, DMA relied solely on *Quill* for its undue burden claim. The Tenth Circuit reiterated the narrow application of *Quill* to sales and use tax collection. Given that the Colorado law's notice and reporting requirements did not involve collection, the *Quill* physical presence requirement did not apply and the law did not unduly burden interstate commerce.

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