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E-COMMERCE

10th Circuit Upholds Colorado's Tax Scheme For Out-Of-State Retailers

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A Colorado law that imposes notification and reporting requirements on out-of-state retailers selling to state residents neither discriminates against the retailers — including e-commerce sites — nor places an undue burden on interstate commerce, a federal appeals court has ruled.

Direct Marketing Association v. Brohl, No. 12-1175, 2016 WL 692500 (10th Cir. Feb. 22, 2016).

The state of Colorado, which had lost a U.S. Supreme Court battle to keep the issue out of federal court, convinced the 10th U.S. Circuit Court of Appeals that the law does not violate the Constitution's so-called dormant Commerce Clause.

The law does not impose discriminatory economic burdens on out-of-state retailers, the 10th Circuit ruled.

Rather, its notice-and-reporting obligations merely aid the state in increasing compliance with pre-existing tax obligations, the panel said.

COLORADO'S LAW

The case involves Colorado House Bill 10-1193.

Democratic Gov. John Hickenlooper signed the bill into law in 2010 largely in reaction to the recent surge of e-commerce websites and online shopping, according to the 10th Circuit panel's opinion.

States such as Colorado have lost significant revenue because they cannot require retailers without a physical presence within their borders to collect sales or use taxes from customers, the panel said.

This limitation on what tax responsibilities states can require from out-of-state retailers is based on two Supreme Court decisions interpreting the Constitution's Commerce Clause: *National Bellas Hess Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

Under these precedents, in-state customers that buy from out-of-state retailers must report their own use-tax liability to a state's revenue department, the panel said.

On the other hand, brick-and-mortar stores in Colorado must collect sales or use taxes from customers at the point of sale and remit this money to the state's revenue department, the panel said.

To recoup some of the state's lost revenue, Colorado's 2010 law imposed reporting and notification requirements on retailers that do not have a physical presence in Colorado but that have more than $100,000 in gross sales.

Every year, these "non-collecting" retailers must notify their customers about the use taxes due to the state and report a list to Colorado's revenue department with customer names, addresses and total amounts of their purchases.

The law imposes a $5 or $10 penalty when a retailer fails to send these notifications or reports.

RISE THROUGH THE COURTS

Right after the bill became law, the Direct Marketing Association challenged it in the U.S. District Court for the District of Colorado. The court enjoined Colorado's enforcement of the requirements on out-of-state retailers, finding they impermissibly discriminated against and imposed undue burdens on interstate commerce.

Colorado appealed, and the 10th Circuit reversed the lower court's decision, saying the Tax Injunction Act barred the federal courts' jurisdiction.

The TIA, 28 U.S.C.A. § 1341, requires federal courts to defer jurisdiction in cases involving state tax "assessment, levy or collection."

Looking to the plain meaning of the TIA, the unanimous Supreme Court found it did not apply to Colorado's notice-and-reporting obligations. *Direct Mktg. Ass'n v. Brohl*, No. 13-1032, 2015 WL 867663 (U.S. Mar. 3, 2015).

In a concurring opinion, Justice Anthony Kennedy highlighted the "serious, continuing injustice" that Colorado and other states face as more residents shop online and do not pay sales tax to local brick-and-mortar stores.

DISCRIMINATION OR UNDUE BURDEN?

On remand, the 10th Circuit analyzed the Colorado law to determine if it violated the dormant Commerce Clause, discriminated against out-of-state retailers or placed an undue burden on interstate commerce.

The three-judge panel held that it did not.

The law's notice-and-reporting obligations differ from a requirement that out-of-state retailers collect and remit sales and use taxes, a scheme that the U.S. Supreme Court considered unlawful in *Quill*, the opinion said.

Writing in a concurrence, U.S. Circuit Judge Neil M. Gorsuch highlighted why the Colorado law is lawful and not precluded by *Quill*.

"The plaintiffs haven't come close to showing that the notice and reporting burdens Colorado places on out-of-state mail order and Internet retailers compare unfavorably to the administrative burdens the state imposes on in-state brick-and-mortar retailers who must collect sales and use taxes," he wrote.

Steven J. Kolias, counsel at Dechert LLP who specializes in state taxation issues, said the 10th Circuit's narrow interpretation of *Quill* is consistent with — and may well be a result of — Justice Kennedy's concurring opinion, which questioned the relevance of a physical-presence requirement in an online economy.

"Justice Kennedy's concurrence intimated that the court would welcome a case that provides a chance to reconsider the *Quill* standard," said Kolias, who is not involved in the lawsuit.

The DMA has asked for more time to file a rehearing petition, but Bruce Ely, co-chair of the state and local tax practice group at Bradley Arant Boult Cummings LLP, said he doubts the 10th Circuit will grant it.

"With a 3-0 vote and such a strong opinion, it's pretty clear that the judges have their minds made up and I doubt the other judges on the 10th Circuit wish to intervene," according to Ely. He is not involved with the case.

'Not a surprise': Tax attorney responds to *DMA v. Brohl*

Bruce Ely, a partner and co-chair of the state and local tax practice group at Bradley Arant Boult Cummings LLP, discusses the recent decision in *Direct Marketing Association v. Brohl*, No. 12-1175, 2016 WL 692500 (10th Cir. Feb. 22, 2016).

Ely works in the firm's Birmingham, Alabama, office. He also serves as an adjunct professor in the Culverhouse School of Accountancy at the University of Alabama.

Westlaw Journals: Was this decision expected?

Bruce Ely: It was not a surprise to many of us, especially knowing that one of Justice Anthony M. Kennedy's former law clerks is one of the three judges on the [10th Circuit] panel and who wrote a concurring opinion that clearly echoed Justice Kennedy's sentiments in the prior *DMA* ruling. *Direct Mktg. Ass'n v. Brohl*, No. 13-1032, 2015 WL 867663 (U.S. Mar. 3, 2015).

WJ: Do you think the 10th Circuit panel properly considered Justice Kennedy's concurrence?

BE: It certainly seemed to have influenced them, but the jury is out on whether the 10th Circuit went too far in light of *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and stare decisis. The tragic loss of Justice Antonin Scalia (who voted for Quill Corp. and against North Dakota based on stare decisis) may have an effect if DMA eventually applies for certiorari.

WJ: Do you think the panel properly applied *Quill*, limiting it to the collection of sales and use taxes versus the Colorado law's notification and reporting obligations?

BE: On balance, this was not a surprising distinction to be made, and the fact that DMA was successful in convincing the court earlier that the Tax Injunction Act didn't apply to keep them out of federal court seems to have bitten them in the hindpart.

WJ: Based on the decision, do you think that more states will enact these kinds of laws? Have they already? Are other circuits considering similar questions?

BE: That's very likely, but a number of states are already taking the Alabama approach and mounting a frontal assault on *Quill*. So a notice-and-reporting-requirement statute like Colorado's may seem like a Plan B to many states now. The Alabama approach is a regulation that revives our [state's] pre-*Quill* economic nexus statute and warns that if an out-of-state Internet or catalog vendor had sales last calendar year in excess of $250,000 to Alabama customers, they must register with the Alabama Department of Revenue and collect and remit sales tax starting Jan. 1 of this year. Several other states are in the process of enacting economic nexus statutes rather than issuing a regulation. All those I consider frontal assaults, rather than a statute that simply requires an Internet vendor to post a warning on its website to its customers, a la Colorado.

WJ: The DMA also filed an extension asking for more time to file a petition for rehearing. What is your take on whether or not that will be granted?

BE: I doubt the 10th Circuit will grant a rehearing. With a 3-0 vote and such a strong opinion, it's pretty clear that the judges have their minds made up and I doubt the other judges on the 10th Circuit wish to intervene.