

April 3, 2012

Colorado's Use Tax Reporting Regime Declared Unconstitutional

On March 30, 2012, the U.S. District Court for the District of Colorado permanently enjoined the enforcement of Colorado's sales and use tax notice and reporting requirements. *The Direct Marketing Association v. Roxy Huber*, Civil Case No. 10-CV-01546-REB-CBS, Order Concerning Cross Motions for Summary Judgment (U.S. Dist. Ct. Colorado, March 30, 2012).

Background

On February 24, 2010, Colorado enacted a law subjecting out-of-state retailers to certain sales and use notification and reporting requirements. Specifically, the use tax reporting regime (the Reporting Requirements) established three new obligations for most out-of-state retailers:

- (1) Retailers must notify their customers that the retailers did not collect Colorado sales tax, and the customers are obligated to self-report and pay Colorado use tax;
- (2) Retailers must provide each customer with an annual report detailing the customer's purchases in the previous calendar year, informing the customer of an obligation to report use tax and that the retailer is obligated to report the customer's name and total amount of purchases to the Colorado Department of Revenue (Department); and
- (3) Retailers must provide to the Department an annual report describing Colorado customers' names, billing addresses, shipping addresses and the total amount of purchases.

Exceptions to the Reporting Requirements are provided to certain small sellers or small sales.

The Direct Marketing Association (DMA) challenged the constitutionality of the reporting regime by filing a suit in federal court seeking a declaration that it was unconstitutional and seeking an injunction preventing the Department from enforcing these requirements. The DMA asserted two claims that the Colorado notice and reporting regime violated the dormant Commerce Clause: (1) the regime discriminates impermissibly against out-of-state retailers; and (2) the regime imposes undue burdens on interstate commerce.

As previously [reported](#), on January 26, 2011, the court granted DMA's motion for a preliminary injunction suspending the enforcement of the use tax notice and reporting regime pending the court's final determination in the case.

The Reporting Requirements Discriminate Against Out-of-State Retailers

The court noted that while on its face the law did not distinguish between in-state and out-of-state retailers, "the veil provided by the words of [the law] is too thin to support the conclusion that the [law] regulate[s] in-state and out-of-state retailers even-handedly." The court reasoned that while in-state retailers are subject to obligations to collect and remit Colorado sales tax, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) prohibits the state from imposing the same obligations on out-of-state retailers with no physical presence in the state. As a result, the distinction between collecting and non-collecting retailers, explained the court, had the effect of imposing a unique burden on out-of-state retailers since the burden is imposed precisely because those retailers are entitled to the protection of *Quill*. Thus, the

© 2012 Sutherland Asbill & Brennan LLP. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

court concluded that the Colorado law “patently discriminates” against interstate commerce in violation of the Commerce Clause.

The court noted that the Department failed to meet its “very high burden of proof under the strict scrutiny standard” to overcome the facial invalidity of the Colorado law.

Sutherland Observations: The Department offered various reasons in support of the Reporting Requirements, including the Department’s enhanced ability to recover sales and use tax revenue and fair distribution of the cost of government. The DMA advanced three nondiscriminatory alternatives to serve these purposes, including collecting use tax directly from Colorado purchasers on the state’s income tax return and increased business consumer audits. The Department spent little time addressing the alternatives offered by the DMA, only explaining that the Department had in the past attempted to collect use tax directly from Colorado consumers; however, that practice was discontinued because it proved unsuccessful.

The Reporting Requirements Create an Undue Burden on Interstate Commerce

With regard to DMA’s second claim, the court held that the Reporting Requirements impose an undue burden on interstate commerce because they impermissibly impose a use tax collection burden on a non-physically present retailer. In so holding, the court analogized the Colorado notice and reporting regime to the unconstitutional use tax regime in *Quill*. While the court agreed that the holding in *Quill* has a very “narrow focus on sales and use taxes,” the sole purpose of Colorado’s notice and reporting requirements is the ultimate collection of use taxes. As a result, the court found that “the burdens imposed by the [Colorado law] are inextricably related in kind and purposes to the burdens condemned in *Quill*.” The Reporting Requirements imposed these burdens on retailers with no nexus in the state. Thus, the court concluded the Reporting Requirements violate *Quill*.

Sutherland Observations: Attempts to subject remote sellers to notice and reporting requirements were interpreted as attempts to coerce out-of-state businesses to collect and remit tax. It is important to note that the court struck down the requirements to report transactions to the Department *and* requirements to report to customers.

The court’s order to invalidate the Reporting Requirements to both customers and the Department calls into question the validity of the notice and reporting regimes adopted by other states, including Oklahoma, South Dakota, Vermont, South Carolina and Tennessee.

Sutherland Observations: The court’s decision could be viewed as an example of a taxpayer-friendly decision by a federal court. In October 2010, the U.S. District Court for the District of Washington granted a taxpayer’s motion for summary judgment and held that the North Carolina Department of Revenue was not entitled to demand both product and customer information as part of its sales tax audit. *Amazon.com, LLC v. Kenneth R. Lay*, Case No. C10-664 MJP (W.D. Wash. Oct. 25, 2010) (discussed in our October 27, 2010 [Legal Alert](#)). The results of these cases could contribute to some taxpayers’ beliefs that federal courts provide a fair and neutral forum for adjudicating state tax claims. However, federal court jurisdiction often is not an option because of the federal Tax Injunction Act.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Michele Borens	202.383.0936	michele.borens@sutherland.com
Jonathan A. Feldman	404.853.8189	jonathan.feldman@sutherland.com
Jeffrey A. Friedman	202.383.0718	jeff.friedman@sutherland.com
Stephen P. Kranz	202.383.0267	steve.kranz@sutherland.com
Carley A. Roberts	916.241.0502	carley.roberts@sutherland.com
Marc A. Simonetti	212.389.5015	marc.simonetti@sutherland.com
Eric S. Tresh	404.853.8579	eric.tresh@sutherland.com
W. Scott Wright	404.853.8374	scott.wright@sutherland.com
Douglas Mo	202.383.0847	douglas.mo@sutherland.com
Prentiss Willson	415.819.7985	prentiss.willson@sutherland.com
Pilar Mata	202.383.0116	pilar.mata@sutherland.com
Michele L. Pielsticker	916.498.3311	michele.pielsticker@sutherland.com
Diann L. Smith	202.383.0884	diann.smith@sutherland.com
Jack Trachtenberg	212.389.5055	jack.trachtenberg@sutherland.com
Marlys A. Bergstrom	404.853.8177	marlys.bergstrom@sutherland.com
Andrew D. Appleby	212.389.5042	andrew.appleby@sutherland.com
Zachary T. Atkins	404.853.8312	zachary.atkins@sutherland.com
Madison J. Barnett	404.853.8191	madison.barnett@sutherland.com
Scott A. Booth	202.383.0256	scott.booth@sutherland.com
Michael L. Colavito, Jr.	202.383.0870	mike.colavito@sutherland.com
Miranda K. Davis	404.853.8242	miranda.davis@sutherland.com
Lisbeth A. Freeman	202.383.0251	beth.freeman@sutherland.com
Timothy A. Gustafson	916.241.0507	tim.gustafson@sutherland.com
Charles C. Kearns	202.383.0864	charlie.kearns@sutherland.com
Jessica L. Kerner	212.389.5009	jessica.kerner@sutherland.com
Fabio Leonardi	202.383.0881	fabio.leonardi@sutherland.com
David A. Pope	212.389.5048	david.pope@sutherland.com
Melissa J. Smith	202.383.0840	melissa.smith@sutherland.com
Maria M. Todorova	404.853.8214	maria.todorova@sutherland.com