



## State & Local Tax Advisory ■

**FEBRUARY 26, 2016**

### *Direct Marketing Association v. Brohl: What's Quill Got to Do with It?*

On February 22, 2016, the U.S. Court of Appeals for the Tenth Circuit issued its decision in *Direct Marketing Ass'n v. Brohl*.<sup>1</sup> The Tenth Circuit reversed the federal district court and held that Colorado's law imposing use tax notice and reporting obligations on retailers does not discriminate against or unduly burden interstate commerce and therefore does not violate the dormant Commerce Clause. The court's determination rested on its interpretation of the U.S. Supreme Court's holding in *Quill Corp. v. North Dakota*,<sup>2</sup> which the court concluded applies narrowly to sales and use tax collection and does not forbid states from imposing regulatory requirements on "retailers that are not otherwise required to comply with the greater burden of tax collection and reporting." The decision is extremely important for taxpayers and consumers alike.

#### **Background**

In an effort to increase Colorado residents' voluntary payment of the state's use tax on purchases made online, in 2010 the Colorado legislature passed H.B. 10-1193, which required "non-collecting retailers"<sup>3</sup> to: (1) send a transactional notice to purchasers informing them that they might be subject to Colorado's use tax; (2) provide Colorado purchasers who buy goods from the retailer totaling more than \$500 an annual purchase summary; and (3) file an annual customer information report with the Department of Revenue.

In response to the law's enactment, a trade group called the Direct Marketing Association (DMA) filed a facial challenge to the law in federal district court in 2010 alleging, among other claims, that the law violates the dormant Commerce Clause because it discriminates against and unduly burdens interstate commerce. On March 30, 2012, the federal district court granted summary judgment to DMA on both grounds and permanently enjoined the state Department of Revenue from enforcing the law.

<sup>1</sup> *Direct Marketing Ass'n v. Brohl*, No. 12-1175 (10<sup>th</sup> Cir. February 22, 2016).

<sup>2</sup> 504 U.S. 298 (1992).

<sup>3</sup> A non-collecting retailer is defined as a retailer that sells goods to Colorado purchasers but does not collect Colorado sales or use tax.

The department appealed. On August 20, 2013, the Tenth Circuit held that the federal district court lacked jurisdiction to hear DMA's challenge under the Tax Injunction Act, and it remanded the case to the district court to dismiss DMA's claims and dissolve the permanent injunction,<sup>4</sup> which it did on December 10, 2013.

Subsequently, DMA sued the department in state court and petitioned for certiorari to the U.S. Supreme Court seeking review of the Tenth Circuit's dismissal of its claims based on the Tax Injunction Act. On February 18, 2014, the state district court preliminarily enjoined the enforcement of the law.<sup>5</sup> On July 1, 2014, the Supreme Court granted DMA's petition for certiorari and on March 3, 2015, held that the Tax Injunction Act did not strip the federal courts of jurisdiction to hear DMA's challenge.<sup>6</sup> Accordingly, [the Supreme Court reversed \*Brohl I\* and remanded the case](#) to the Tenth Circuit for further proceedings.

Although the Supreme Court determined that federal courts have jurisdiction in this case, it did not express a view on the merits—i.e., whether the notice and collection requirements imposed by the law in fact constitute violations of the Commerce Clause. After years of procedural wrangling, the Tenth Circuit has now weighed in on the substantive merits of the case, and the holding is—to say the least—troubling for taxpayers.

## The Court's Holding

The Tenth Circuit framed its analysis as turning on the proper scope and application of *Quill*, ultimately concluding that "*Quill* applies narrowly to and has not been extended beyond tax collection" itself. Therefore, according to the Tenth Circuit, the limitations set forth in *Quill* are of no import to Colorado's reporting requirements—simply a regulatory obligation.

The Tenth Circuit then explained how the federal district court's improper application of *Quill* resulted in that court's erroneous holding that the law is discriminatory. According to the federal district court, under state law, all retailers doing business in Colorado and selling to Colorado customers must obtain a sales tax license and collect and remit the applicable sales tax. *Quill* precludes the state from imposing such requirements on out-of-state retailers that do not have a physical presence in the state. The district court reasoned that, taken together, state law and *Quill* "guarantee" that the reporting obligations imposed under the law apply only to out-of-state retailers and therefore the law directly regulates and discriminates against out-of-state retailers and, thus, interstate commerce. The district court viewed the law's application to "any retailer that does not collect Colorado sales tax" as a thinly veiled attempt to solely regulate out-of-state retailers.

The Tenth Circuit took issue with the underpinning of the district court's analysis that *Quill* applied to create a facially discriminatory law. Since *Quill* applies narrowly to sales and use tax collection, whereas the law in this case concerns a regulatory notice and reporting requirement, the Tenth Circuit concluded that the

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<sup>4</sup> *Direct Mktg. Ass'n v. Brohl* ("*Brohl I*"), 735 F.3d 904, 906, 921 (10th Cir. 2013).

<sup>5</sup> *Direct Mktg. Ass'n v. Colo. Dep't of Revenue*, No. 13 CV 34855, at 1, 22-23 (Dist. Ct. Colo. Feb. 18, 2014).

<sup>6</sup> *Direct Mktg. Ass'n v. Brohl* ("*Brohl II*"), 135 S.Ct. 1124, 1131 (2015).

federal district court's reliance on *Quill* was in error and explained how its conclusion in that regard affects DMA's dormant Commerce Clause claims both of discrimination and of undue burden.

## **Discrimination**

DMA argued that Colorado's notice and reporting requirements discriminated against interstate commerce. The Tenth Circuit dismissed that argument, however, holding that there is no discrimination because the law does not distinguish between in-state and out-of-state economic interests; rather, it imposes differential treatment based on whether or not a retailer collects Colorado sales or use taxes. The court also noted that when the Supreme Court has determined that a law is facially discriminatory, it has done so based on statutory language that specifically identifies geographical distinctions (i.e., "in-state" versus "out-of-state"). The Tenth Circuit concluded that the law at issue makes no such distinction and is therefore not facially discriminatory.

The Tenth Circuit also determined that the law is not discriminatory in its direct effects and held that DMA was incorrect that (1) any differential treatment between in-state and out-of-state entities results in a violation of the dormant Commerce Clause; and (2) the law should not be viewed in isolation. Specifically, the court held that the notice and reporting obligations imposed on out-of-state retailers are only discriminatory if they result in differential treatment of in-state and out-of-state economic interests that benefit the former and burden the latter. The court emphasized that although *Quill* establishes that out-of-state retailers with no physical presence in a state are free from tax collection/remittance requirements, it does not establish that they are free from all *regulatory* requirements. Further, in-state retailers must obtain a license, collect sales taxes, hold them in trust, calculate the state and local tax due, file a return and remit the tax to the state. The court held that in comparing the regulatory requirements imposed on out-of-state versus in-state retailers, there was no evidence that, in totality, the requirements for out-of-state retailers are more burdensome than those for in-state retailers.

The court also found that disparate treatment is not unequal treatment or discrimination if the subjects of such treatment are not themselves similarly situated. In this case, the court determined that non-collecting, out-of-state retailers are not similarly situated to in-state retailers that must comply with tax collection and reporting requirements that are not (by virtue of *Quill*) imposed on out-of-state, non-collecting retailers.

Finally, the Tenth Circuit found that the Supreme Court has repeatedly held that laws are to be understood in their broader context rather than in isolation. Here, as the Tenth Circuit noted, the reporting requirements under the law 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. The court concluded that when considered against the backdrop of the collecting retailers' tax collection and reporting obligations, DMA had failed to show that the law imposes a discriminatory economic burden on out-of-state vendors by altering the competitive balance between in-state and out-of-state firms.

## **Undue Burden**

In addressing whether the law unduly burdens interstate commerce, the Tenth Circuit again emphasized

the importance of *Quill* by first explaining that the federal district court had misapplied *Quill* by relying on its bright-line physical presence test. Specifically, the federal district court held that although *Quill* itself narrowly focuses on sales and use taxes, the sole purpose of the Colorado law is to enhance the collection of use taxes by the state—a purpose which makes the Colorado law inextricably related in kind and purpose to the burdens prohibited under *Quill*.

The Tenth Circuit, however, having determined that *Quill* was not controlling, viewed the issue quite differently. First, the court reemphasized that the Supreme Court has characterized *Quill* as establishing that a state may not require retailers who lack a physical presence in the state to *collect* sales and use taxes on behalf of the Department of Revenue. In contrast, the notice and reporting requirements at issue in this case precede any assessment and collection of taxes because the department must still take further action to assess tax and collect payment from Colorado taxpayers whose purchases are the subject of the law's reporting requirements. Second, the court determined that the Supreme Court's holding that the Tax Injunction Act does not preclude DMA's lawsuit necessarily means that *Quill* does not have the broad effect asserted by DMA in the suit. Specifically, the Tenth Circuit held, given the Supreme Court's holding that the relief sought in this litigation would not "enjoin, suspend, or restrain the assessment, levy, or collection of tax under state law," *Quill* must not be so broad so as to apply to Colorado's notice and reporting requirements (because if it did, the Tenth Circuit suggested, an order striking down those requirements under *Quill* would be a restraint on state tax collections). Because *Quill* is not controlling, the law's notice and reporting requirements are not subject to the bright-line test and the undue burden inquiry is ended.

## Conclusions and Observations

The Tenth Circuit created an interesting dichotomy in analyzing the issues addressed in its opinion. For the purposes of analyzing whether both *Quill* and the four-prong test under *Complete Auto*<sup>7</sup> should apply to its analysis of the Colorado law, the Tenth Circuit concluded that because the law does not enforce the *collection* of tax, the law need not meet the standards set forth in either decision. However, for the purpose of analyzing the potential discrimination and undue burden on interstate commerce, the Colorado law is viewed by the Tenth Circuit as part of the entire taxing program of the state and, therefore, was not discriminatory or unduly burdensome when compared with the collection obligations of in-state taxpayers. This type of hair splitting may be fair to use when respecting *stare decisis* while limiting the application of the bright-line physical presence test from *Quill*, but we should question whether it also makes sense to summarily conclude that the analysis under *Complete Auto* is also inapplicable to the Colorado law, which the Tenth Circuit concedes in its analysis is part of the "entire [tax] program" and repeatedly cites *West Lynn Creamery*<sup>8</sup> to support that proposition.

Through its reasoning in this opinion, the Tenth Circuit has also effectively shifted the burden of reaching a final resolution on the various arguments asserted by DMA to Congress. The Tenth Circuit specifically noted "the Supreme Court's observation in *Quill* that Congress holds the 'ultimate power' and is 'better qualified

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<sup>7</sup> *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

<sup>8</sup> *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994).

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.'"

In the meantime, under the Tenth Circuit's narrow interpretation of *Quill*, states may impose regulatory requirements that, although not requiring the collection of use tax on their face, are closely related to such an imposition. According to the Tenth Circuit, *Quill* stands for the narrow proposition that a state cannot impose *collection* obligations without a physical presence requirement, and it does not prohibit states from imposing other requirements, no matter how closely related they are to a collection obligation (or how explicitly motivated they are by a desire to coerce collection). This holding could well lead to the promulgation of additional "informational" reporting requirements that would not be encumbered by a Commerce Clause nexus analysis. The Tenth Circuit's analysis will likely embolden states to tiptoe the line between permissible reporting requirements and impermissible collection obligations. Indeed, we would expect many states to follow suit.

Interestingly, the Tenth Circuit left open several channels through which taxpayers might challenge its holding. Specifically, the court stated in its analysis that the Supreme Court in *Quill* determined that "the dormant Commerce Clause and *National Bellas Hess, Inc.*<sup>9</sup> create a safe harbor wherein 'vendors whose only connection with customers in the taxing State is by common carrier or the United States mail ... are free from state-imposed duties to collect sales and use taxes.'" According to the Supreme Court in *Bellas Hess*, the purpose of such a safe harbor is to ensure an economy that is free from the burden of such local entanglements. However, nowhere in its decision did the *Bellas Hess* Court distinguish between the burden of collecting taxes and keeping the related records, nor did the Court state that although taxpayers are relieved from the burden of collecting taxes, they are not relieved from the burden of reporting. Considering that the burden of collecting and remitting taxes is inextricably linked with recordkeeping and that neither burden is objectively greater than the other, the Tenth Circuit's separation of those burdens—one being deemed constitutionally sound while the other is not—might provide an opportunity for a future appeal.

The Tenth Circuit also stated in a footnote that although the regulatory requirements upheld through its decision must satisfy the due process requirements, DMA had not made a due process challenge in its motion for summary judgment or its arguments on appeal. In fact, the court noted more than once that DMA failed to carry its burden, which raises the question of whether this case could have ended up differently had DMA focused on different aspects of proof. Thus, it is conceivable that a taxpayer could challenge the law as unconstitutional if it is applied to the taxpayer under the Due Process Clause.

Finally, Judge Neil Gorsuch drafted a well-written concurrence, which is very much worth reading, even if one might disagree with the conclusion. Judge Gorsuch reasoned that the Supreme Court in *Quill* acknowledged both that states can constitutionally impose tax and regulatory burdens on out-of-state firms that are more or less comparable to sales and use tax collection duties, and that the dichotomy between impermissible and permissible burdens is "artificial" and "formalistic." Thus, in Judge Gorsuch's reasoning, because the Supreme Court affirmed the physical-presence rule in *Quill* not because of any important principle but purely out of respect for precedent, its holding should not be extended beyond its express scope. Accordingly,

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<sup>9</sup> *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967).

he concurred with the Tenth Circuit's holding because, in his view, respect for *Quill's* reasoning means that the Tenth Circuit must respect the physical-presence standard affirmed in *Quill* and—just as surely—that it would be inappropriate for the Tenth Circuit to extend *Quill's* reasoning to prohibit regulatory obligations that are imposed by states with the apparent or express purpose of coercing remote retailers to collect taxes on sales into a state, even when *Quill* does not permit the state to impose such collection obligations.

It is unclear what other states might do in the wake of this decision. On the one hand, the decision could certainly motivate states to enact similar (or more onerous) requirements. On the other hand, these types of laws may not be a panacea to offset the alleged evaporation of sales and use tax revenues. States that enact these laws and thus receive this information from out-of-state retailers are then faced with the potentially unpopular option of sending tax bills to their residents.

It will be interesting to see if the Supreme Court decides to grant certiorari to DMA a second time, given its initial review of the jurisdictional issue and in light of the numerous editorial, legislative and judicial attacks on *Quill* in recent months.

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If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Samantha M. Bautista  
213.576.1052  
[samantha.bautista@alston.com](mailto:samantha.bautista@alston.com)

Zachry T. Gladney  
212.210.9423  
[zach.gladney@alston.com](mailto:zach.gladney@alston.com)

Edward Tanenbaum  
212.210.9425  
[edward.tanenbaum@alston.com](mailto:edward.tanenbaum@alston.com)

Mary T. Benton  
404.881.7255  
[mary.benton@alston.com](mailto:mary.benton@alston.com)

Matthew P. Hedstrom  
212.210.9533  
[matt.hedstrom@alston.com](mailto:matt.hedstrom@alston.com)

Rachel Trickett  
212.210.9432  
[rachel.trickett@alston.com](mailto:rachel.trickett@alston.com)

Clark R. Calhoun  
213.576.1137  
[clark.calhoun@alston.com](mailto:clark.calhoun@alston.com)

Kendall L. Houghton  
202.239.3673  
[kendall.houghton@alston.com](mailto:kendall.houghton@alston.com)

Charles D. Wakefield  
212.210.1281  
[charles.wakefield@alston.com](mailto:charles.wakefield@alston.com)

John L. Coalson, Jr.  
404.881.7482  
[john.coalson@alston.com](mailto:john.coalson@alston.com)

Richard C. Kariss  
212.210.9452  
[richard.kariss@alston.com](mailto:richard.kariss@alston.com)

Andrew W. Yates  
404.881.7677  
[andy.yates@alston.com](mailto:andy.yates@alston.com)

Jasper L. Cummings, Jr.  
919.862.2302  
[jack.cummings@alston.com](mailto:jack.cummings@alston.com)

Ethan D. Millar  
213.576.1025  
[ethan.millar@alston.com](mailto:ethan.millar@alston.com)

Michael M. Giovannini  
404.881.7957  
[michael.giovannini@alston.com](mailto:michael.giovannini@alston.com)

Michael T. Petrik  
404.881.7479  
[mike.petrik@alston.com](mailto:mike.petrik@alston.com)

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777  
 BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN  
 BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719  
 CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111  
 DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899  
 LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100  
 NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444  
 RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260  
 SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001  
 WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333