STATE AND LOCAL TAXATION: THE TENTH CIRCUIT SUSTAINS COLORADO'S REPORTING REQUIREMENT FOR OUT-OF-STATE RETAILERS

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Under controlling precedent, sales and use taxes stop at the state line:

- In 1967, the Supreme Court held that under the due process clause and the dormant commerce clause, Illinois could not require a mail order business based in Missouri to collect use taxes associated with goods that it sold to Illinois residents when its sole connections with Illinois involved the mail and common carriers. *See Nat'l Bellas Hess v. Dep't of Revenue*, 386 U.S. 753, 758-60 (1967).
- In 1992, the Supreme Court revisited the area; the Court overturned its prior due process ruling in National Bellas Hess while upholding a bright-line physical presence rule for purposes of the dormant commerce clause. Consequently, the principle that sales and use taxes stop at the state line remained in force. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 307-08, 317-18 (1992). But the Court's endorsement of the bright-line physical presence rule was lukewarm, as it rested primarily on respect for precedent. Id.; see also id., 504 U.S. at 320 (Scalia, J. concurring). And Justice White dissented, asserting that *National Bellas Hess* should have been overturned in its entirety. Id. at 321-33 (White, J. dissenting).

A lot has changed since 1992. When the Court decided *Quill*, the internet was in its infancy. Now, it's fully grown, and internet commerce is a huge industry. The impact of *Quill* in this context has been grave; states have been losing significant revenue because customers of internet retailers rarely comply with their use tax obligations.

Colorado attacked this problem with a law that imposed notice and reporting requirements on retailers who sell in the state but do not collect sales tax. Monday, the Tenth Circuit sustained the Colorado statute, rejecting a challenge from the Direct Marketing Association under the dormant commerce clause. *Direct Mktg. Ass'n v. Brohl*, No. 12-1175, 2016 U.S. App. LEXIS 3037 (10th Cir. Feb. 22, 2016).

The case has a lengthy history:

- In 2012, the trial court enjoined the enforcement of the statute as a violation of the dormant commerce clause;
- In 2013, the Court of Appeals reversed, ruling that the Tax Injunction Act deprived the district court of jurisdiction;
- In 2015, the Supreme Court reversed the Tenth Circuit, holding that the Tax Injunction Act was not applicable because the Colorado statute did not involve an effort to assess, levy or collect a tax.

See Direct Mktg. Ass'n v. Huber, No. 10-cv-01546 REB-CBS, 2012 U.S. Dist. LEXIS 44468, *22-*30 (D. Colo. Mar. 30, 2012), rev'd sub nom. *Direct Mktg. Ass'n v. Brohl*, 757 F.3d 904, 915-21 (2013), *rev'd*, 135 S. Ct. 1124, 1129-33 (2015).

Following remand, the Tenth Circuit turned to the merits of the retailers' dormant commerce clause challenge and held that the notice and reporting requirements of Colorado law did not violate the dormant commerce clause.

The Tenth Circuit began its analysis by reviewing the basics of dormant commerce clause jurisprudence, noting that the dormant commerce clause is relevant to state laws that interfere with interstate commerce, particularly laws that involve "economic protectionism." *Direct Mktg. Ass'n v. Brohl*, 2016 U.S. App. LEXIS 3037, *12 (citation omitted). The court then explained that state laws that discriminate against interstate commerce will only be sustained where the state demonstrates that the law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Id.* at *14 (quoting *Camps Newfound/Owatonna Inc. v. Town of Harrison*, 520 U.S. 564, 581 (1997)). Next, the court noted that "[n]ondiscriminatory state laws also can be invalidated when they impose an undue burden on interstate commerce." *Id.* (quoting *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 529 (1959)). The court rounded out its synopsis of the relevant principles with a review of the dormant commerce clause analysis for state taxes under *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which it determined was not applicable because the case did not involve a tax. Id. at *15.

Against this background, the court turned to the specific Colorado statute, which required that retailers who do not collect sales tax do three things: first, the retailers were required to send a notice to Colorado-based customers in conjunction with each sale, advising them of their obligation to pay use tax; second, the retailers were required to issue to each Colorado purchaser who bought more than $500 worth of goods an annual purchase summary tallying their purchases and reminding them of their use tax obligation; and third, the retailers were required to file an annual information report with the state listing the names and addresses of Colorado customers and the total amounts they had spent. *See id.* at *7. The Tenth Circuit initially considered whether the Colorado statute was inconsistent with Quill; the court concluded that it was not, noting that Quill was focused on the collection of taxes. *Id.* at *17 (citing *Brohl*, 135 S. Ct. at 1127).

After concluding that *Quill* was to be read narrowly to apply solely to the collection of taxes, the Tenth Circuit addressed the retailers' claims that the Colorado law discriminated against interstate commerce. First, the court concluded that the law was not facially discriminatory, as it was aimed at a group of retailers who did not collect sales tax and did not differentiate between "in-state and out-of-state economic interests." *Id.* at *26. While the title of the statute referenced out-of-state retailers,

the Tenth Circuit held that was not meaningful given the statute's plain language, which was squarely aimed at retailers who do not collect sales tax. *Id.* The Court of Appeals also noted that the Supreme Court had traditionally viewed state statutes as facially discriminatory where the statute itself contained "geographical distinctions." *Id.* at *27. The court's analysis here was bolstered by the fact that a number of out-of-state retailers voluntarily complied with Colorado's sales tax.

Next, the court turned to the question whether the Colorado law was discriminatory in effect. Here, the Tenth Circuit concluded that the reporting requirement under the act did not give in-state retailers an inherent advantage over out-of-state retailers, since Colorado consumers were legally obligated to either pay sales tax on their purchases or pay use tax if sales tax was not collected. *Id.* at *30-31. The court also observed that Colorado could properly look at the different circumstances of in-state retailers, who were obligated to collect sales tax and submit related information, and out-of-state retailers who were not obligated to collect sales tax. *Id.* at *31-*32.

Ultimately, the Tenth Circuit concluded that the law's reporting requirements did not hinder the ability of out-of-state retailers to compete: "Here, the reporting requirements 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." *Id.* at *33. The court also concluded that the retailers had failed to demonstrate that the reporting requirements discriminated against out-of-state retailers, noting that they did not "point to any evidence establishing that the notice and reporting requirements for non-collecting out-of-state retailers are more burdensome than the regulatory requirements in-state retailers already face." *Id.* at *37.

The Court of Appeals closed by addressing the question whether the reporting requirements imposed an undue burden on interstate commerce. The district court had concluded that the reporting requirements did so based upon its conclusion that the reporting requirements were inconsistent with *Quill*, and that contention was the basis for the retailers' argument on appeal. *Id.* at *40. In light of its narrow reading of *Quill*, the Tenth Circuit readily concluded that the reporting requirements did not impose an undue burden on interstate commerce. *Id.* at *41-*42.

This is an interesting decision in a very fluid area. The Tenth Circuit's task was made easier by the Supreme Court's prior ruling that the Colorado reporting regime was not an effort to assess, levy or collect a tax, which signaled that *Quill* should be read narrowly. Absent further action by the Supreme Court, the Colorado statute appears to offer a viable approach to adapting sales and use taxes to the current marketplace.

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