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Reinventing the *Quill*? DMA Wins the Initial Battle in Colorado, but the War Wages On

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As previously reported in the *State Tax Return*,[1] the Direct Marketing Association ("DMA") is challenging the constitutionality of Colorado's new use tax notice and reporting regime.[2] On January 26, 2011, Judge Robert Blackburn of the United States District Court for the District of Colorado granted DMA's motion for preliminary injunction, thereby enjoining the Colorado Department of Revenue (the "Department") from enforcing the notice and reporting requirements that the Colorado General Assembly enacted in 2010.[3] Specifically, the preliminary injunction (the "PI") prohibits the Department from enforcing the three separate reporting obligations in all respects until such time as the PI is overturned or superseded by a final decision on the merits.[4] Judge Blackburn entered the PI after determining that DMA was likely to succeed on the merits of both its Commerce Clause challenges. The Department appealed Judge Blackburn's decision to the Tenth Circuit Court of Appeals on February 25, 2011. Although the appeal is currently pending, the PI remains in effect and negates all reporting obligations, including the filing of the Customer Information Report that was due March 1.

DMA Challenges the New Regime

In early 2010, the Colorado General Assembly enacted legislation targeted at remote retailers that do not collect and remit Colorado sales tax.[5] The new law, which took effect March 1, 2010, obliges such "non-collecting retailers" to (1) notify all Colorado purchasers at the time of each individual purchase that use tax is owed on all nonexempt purchases (the "Transactional Notice"); (2) send each of its Colorado purchasers an annual notice via first-class mail by January 31 summarizing the Colorado purchaser's Colorado purchases for the preceding calendar year (the "Annual Purchase Summary"); and (3) file an annual report with the

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[1] Justin R. Thompson, *DMA Challenges Colorado's "Non-Collecting Retailer" Notice and Reporting Regime*, JONES DAY STATE TAX RETURN (Sept. 2010).

[2] *See generally Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546-REB-CBS (D. Colo. filed June 30, 2010).

[3] Order Granting Motion for Preliminary Injunction, *Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546-REB-CBS (D. Colo. Jan. 26, 2011).

[4] *Id.* at 13–15.

[5] *See* H.B. 10-1193, 67th Gen. Assem., 2d Reg. Sess. (Colo. 2010) (amending COLO. REV. STAT. § 39-21-112).

Department on or before March 1 of each year (starting in 2011) showing the total amount each Colorado purchaser paid for its Colorado purchases (the "Customer Information Report").[6]

Under the corresponding regulations, noncompliance leads to significant penalties—$5 each time noncollecting retailers fail to provide a Transactional Notice, $10 each time they fail to send an Annual Purchase Summary, and an additional $10 for each purchaser that should have been included in the Customer Information Report.[7] Although the regulations cap the total penalties for a given retailer at $250,000 for the first noncompliant year, they do not cap penalties in subsequent noncompliant years.[8]

On June 30, 2010, DMA filed a lawsuit in federal district court challenging the novel regime.[9] The thrust of DMA's argument is that the new notice and reporting regime contravenes the Commerce Clause of the United States Constitution under longstanding federal precedent.[10] Since retailers located in Colorado are required to collect sales tax, "non-collecting retailers" are, by definition, remote retailers that sell products to Colorado purchasers via interstate commerce. The notice and reporting requirements therefore apply only to remote retailers with no physical presence in Colorado. The first Commerce Clause violation asserted by the DMA is that the statute and regulations discriminate against interstate commerce by placing a new reporting burden exclusively on remote retailers.[11] Secondly, DMA argues that the statute violates the Commerce Clause because principles established in *Quill Corp. v. North Dakota*[12] prohibit Colorado from placing an undue burden on interstate commerce by imposing cumbersome notice and reporting requirements on retailers with no physical presence in Colorado.[13]

Judge Blackburn Enjoins the Department

On August 13, 2010, DMA filed a motion for preliminary injunction against the Department citing the two Commerce Clause violations described above; the court heard oral argument on January 13, 2011. To succeed, DMA needed to show: (1) a substantial likelihood that it would prevail on the merits of the underlying claims; (2) that it would suffer irreparable

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[6] COLO. REV. STAT. § 39-21-112(3.5)(c)(I), (d)(I)(A), (d)(II)(A).

[7] 39 COLO. CODE REGS. § 21-112.3.5(2)(f)(i), (3)(d)(i), (4)(f)(i).

[8] *Id.* § 21-112.3.5(2)(f)(ii), (3)(d)(ii), (4)(f)(ii).

[9] *See generally* Plaintiff's Original Complaint, *Direct Mktg. Ass'n v. Huber*, No. 10-CV-01546-REB-CBS (D. Colo. filed June 30, 2010).

[10] *See id.* at ¶¶ 54–76.

[11] *Id.* ¶¶ 54–64.

[12] 504 U.S. 298 (1992).

[13] Plaintiff's Original Complaint, *supra* note 9, at ¶¶ 65–76.

harm without the PI; (3) that the potential injury to DMA members outweighed the potential harm to the state; and (4) that the PI was in the public interest.[14]

Judge Blackburn determined that DMA was substantially likely to prevail on the merits of both alternative Commerce Clause grounds. With respect to discrimination, Judge Blackburn held that DMA could likely show that the notice and reporting requirements "impose a burden on interstate commerce that is not imposed on in-state commerce," while the Department was equally unlikely to establish a lack of nondiscriminatory alternatives.[15] On the claim of undue burden, Judge Blackburn accepted DMA's reasoning and concluded that although remote retailers are not directly required to collect sales and use taxes under the new law, the requirements to gather, maintain, and report information "likely impose on out-of-state retailers use tax-related responsibilities that trigger the safe-harbor provisions of *Quill*."[16] The undue-burden analysis in Judge Blackburn's order thus extends *Quill*'s safe harbor beyond direct taxes to shield remote retailers from onerous information-reporting obligations as well.

Judge Blackburn also sided with DMA on the three remaining injunction requirements. He deemed the potential deprivation of DMA members' Commerce Clause rights and loss of unrecoverable compliance costs to constitute irreparable injuries and concluded that the possibility of such injuries outweighed any delay in possibly collecting "some use taxes."[17] According to Judge Blackburn, the public interest would be better served by the injunction since "[t]he enforcement of a law that likely is unconstitutional, even if the goal of the law is important and legitimate, does not serve the public interest."[18]

On the basis of the foregoing analysis, on January 26, 2011, Judge Blackburn issued the PI, which enjoins the Department from enforcing the new law and the corresponding regulations for as long as the PI remains in effect.[19] DMA placed a $5,000 bond in the court's registry to enforce the PI.

The Colorado General Assembly Attempts an Override

On January 19, 2011, legislators introduced two bills in the Colorado Senate aimed at legislatively negating the notice and reporting requirements.[20] Senate Bill 11-073 would have

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[14] Order Granting Motion for Preliminary Injunction, *supra* note 3, at 4 (citing *Prairie Band of Potawatomi Indians v. Pierce*, 253 F.3d 1234, 1246 (10th Cir. 2001)).

[15] *Id.* at 7–8.

[16] *Id.* at 10.

[17] *Id.* at 11–12.

[18] *Id.* at 13.

[19] *Id.* at 13–14.

[20] *See* S.B. 11-073, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011); S.B. 11-056, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011).

repealed the new law along with other tax exemption and credit suspensions passed in 2010.[21] Senate Bill 11-056 attempted to sidestep the notice and reporting requirements by exempting from Colorado use tax all purchases from remote retailers.[22] The passage of either bill would have effectively mooted the current litigation. On February 14, 2011, however, both bills died in the Senate Committee on State, Veterans, and Military Affairs. Despite these failed repeal efforts in Colorado, the PI may at least deter other states from passing similar legislation.

Looking Forward

While the PI does not resolve the case, it suspends the notice and reporting obligations during the pendency of the Department's appeal—and potentially the entire litigation. In the event that the PI is overturned or superseded by a final decision on the merits, the Department could only enforce the legislation prospectively, meaning that remote retailers would not be subject to penalties for noncompliance with the new law while the PI remains in effect.

The PI signifies an important victory for retailers engaging in interstate commerce. Some viewed Colorado's new regime as an attempt to further circumvent *Quill* by imposing cumbersome reporting obligations on out-of-state retailers in lieu of directly taxing them. Judge Blackburn applied *Quill*'s safe harbor to prevent this from happening, though. It remains to be seen whether his decision will revitalize *Quill* and be used as leverage in future cases.

The parties filed a joint status report agreeing to expedite a summary judgment hearing in regard to the Commerce Clause claims without further discovery on February 16, 2011. Nine days later, however, the Department appealed Judge Blackburn's decision on the PI to the Tenth Circuit Court of Appeals. Although the appeal is currently pending, the PI still stands and negates all reporting obligations. Stay tuned for updates on the case in the next edition of the *State Tax Return*.

[21] S.B. 11-073, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011).

[22] S.B. 11-056, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011).