Colorado – Use tax notice and reporting requirement injunction dissolved

August 23, 2013

In brief

In March 2012, a federal district court concluded that Colorado's use tax notice and reporting law discriminated against and placed undue burdens on interstate commerce in violation of the Commerce Clause of the US Constitution. The court entered a permanent injunction prohibiting enforcement of the notice and reporting requirements.

On August 20, 2013, a federal appellate court found that the federal district court did not have jurisdiction over the matter and, therefore, the injunction should be dissolved. Out-of-state retailers selling products to Colorado customers should be aware of the state's notice and reporting requirements and understand when such obligations could go into effect. [*Direct Marketing Ass'n v. Brohl*, 10th Cir. Ct. of App., No 12-1175 (8/20/13)]

In detail

Colorado law

Generally, Colorado law requires retailers that sell products to Colorado customers, but do not collect and remit Colorado use tax, to report certain information about such purchases to the customers and to the Colorado Department of Revenue (DOR). Such retailers must:

- notify Colorado customers that the retailer does not collect Colorado sales tax and, therefore, the customer is obligated to self-report and pay use tax to the DOR
- provide each of their Colorado customers an annual report detailing that customer's purchases from the retailer in the previous calendar year, including a notice that the customer is obligated to pay use tax and that the retailer is obligated to report the customer's name and purchases to the DOR. This requirement applies only to customers who spend more than $500 with the retailer in the calendar year.
- provide the DOR with an annual report, which includes customers' names and total purchases from the retailer. This requirement applies only to retailers with $100,000 or more of Colorado gross annual sales.

While the obligations were operative March 1, 2010, reporting was not scheduled to begin until January 31, 2011. Please click here for our summary of the law.

Federal district court decision

The Direct Marketing Association (DMA) – a group of businesses and organizations that market products via catalogs, advertisements, broadcast media, and the

Internet – filed suit in federal district court to enjoin enforcement of the notice and reporting law. On January 26, 2011, the district court granted DMA a preliminary injunction prohibiting the state from enforcing the notice and reporting requirements.

On March 30, 2012, the US District Court for the District of Colorado struck down Colorado's use tax notice and reporting requirements finding that they facially discriminated against interstate commerce and created an undue burden on interstate commerce. Accordingly, the court entered a permanent injunction prohibiting the DOR from enforcing the notice and reporting requirements. Click here for our summary of the decision. The DOR filed an appeal to the US Court of Appeals (Court).

The federal Tax Injunction Act precludes federal jurisdiction

The Court did not reach the issue of whether the notice and reporting law violates the Commerce Clause because it concluded that the federal courts do not have jurisdiction to hear the matter. Under the federal Tax Injunction Act, 28 U.S.C. sec. 1341, federal district court jurisdiction is prohibited when: (1) an action seeks to enjoin, suspend, or restrain the assessment, levy, or collection of any tax under state law and (2) a plain, speedy, and efficient remedy may be had in the courts of such state.

The Court found that: (1) DMA could not avoid application of the Act merely because it was not a taxpayer and (2) the notice and reporting obligations, while not taxes themselves, were enacted for the sole purpose of increasing use tax collection. Accordingly, the Court held that DMA's suit sought to enjoin the "assessment, levy, or collection of any tax under State law."

Additionally, the Court found that taxpayers could challenge the notice and reporting law in state court by: (1) paying the tax and filing a refund or (2) challenging an assessment by the Department. Because Colorado courts provide avenues for remote retailers to challenge the notice and reporting law, the Court held that a plain, speedy, and efficient remedy is available in the state.

Having satisfied the two requirements under the Act, the Court held that the Act "divested the district court of jurisdiction over DMA's Commerce Clause claims, and we therefore have no jurisdiction to reach the merits of this appeal." As a result, the Court remanded the decision back to the district court to: (1) dismiss DMA's Commerce Clause claims due to lack of jurisdiction and (2) dissolve the permanent injunction entered against the Department.

The takeaway

Although the DOR will soon be released from its restriction on enforcing the state's notice and reporting requirements, it is not clear when it will commence enforcement. We will report on any guidance offered by the DOR regarding its procedures for implementing the notice and reporting requirements.

It is unknown how successful a subsequent constitutional challenge will be in state court. Taxpayers considering such a challenge may find meaningful support in the arguments successfully made before the federal district court.

Taxpayers should also be reminded of the state's movement toward collecting tax from out-of-state retailers. Governor John Hickenlooper signed sales tax remote seller legislation on May 28, 2013. The legislation is contingent on the passage of the federal Marketplace Fairness Act. Click here for our summary of the remote seller law.

Let's talk

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