US Supreme Court – Federal Tax Injunction Act does not bar federal court review of Colorado's sales and use tax notice and reporting law

March 4, 2015

In brief

On March 3, 2015, the US Supreme Court held that the Tax Injunction Act does not bar federal court review of Colorado's sales and use tax notice and reporting law. The Act precludes federal court proceedings that would "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law." The Court found that the information gathering requirements of Colorado's law encompassed activities occurring prior to the assessment, levy, or collection of state tax and, therefore, the Act did not preclude federal litigation challenging the state law. Additionally, the petitioner's challenge merely 'inhibited' and therefore did not 'restrain' the collection of Colorado's sales and use tax.

While expressing no opinion on the outcome, the Court reasoned that it was a decision for the lower court to determine whether the doctrine of 'comity' could serve as a vehicle for the lower court to dismiss the action.

In a concurrence, Justice Kennedy advocated for the reexamination of the physical presence nexus requirement provided in the Court's *Quill* and *Bellas Hess* decisions stating that "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*." [*Direct Marketing Assoc. v. Brohl*, US Sup. Ct. No. 13-1032 (3/3/15)]

In detail

Colorado's sales and use tax notice and reporting law

In 2010, Colorado enacted its sales and use tax notice and reporting law that generally requires noncollecting retailers to (1) notify Colorado purchasers that sales or use tax is due on certain purchases, (2) provide an annual report to certain Colorado purchasers of their purchases for the year, and (3) provide an annual statement to the Colorado Department of Revenue listing their Colorado customers and the total amount paid for Colorado purchases in the prior calendar year. Click here for more detail on the notice and reporting law.

Procedural history

The Direct Marketing Association (DMA), a trade association of businesses that market products directly to consumers, challenged the law in the US District Court for the District of Colorado alleging (for purposes relevant for this appeal) that the law (1) discriminates against interstate commerce and (2) imposes undue burdens on interstate commerce. On March 30, 2012, the district court granted partial summary judgment in favor of

DMA and permanently enjoined enforcement of the notice and reporting requirements. Click here for our summary of the district court decision.

On appeal to the US Court of Appeals for the Tenth Circuit, the court held that the district court lacked jurisdiction over the suit due to the Tax Injunction Act. Click here for our summary of the August 20, 2013, appellate court decision. The Department appealed to the US Supreme Court (Court).

Tax Injunction Act

The Tax Injunction Act provides that the federal district courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law. . . ." The Court reviewed whether: (1) Colorado's notice and reporting law was an 'assessment,' 'levy,' or 'collection' of tax; and (2) whether the notice and reporting law was a 'restraint' on such an assessment, levy, or collection.

Notice and reporting law is not an assessment, levy, or collection of tax

Reviewing each term, the Court determined that, generally, 'assessment' refers to an official action taken based on information already reported to the taxing authority, 'levy' refers to an official government action imposing tax, and 'collection' occurs after a formal assessment.

Accordingly, the Court concluded that each term (assessment, levy, and tax) refers to discrete phases of the taxation process that do not include informational notices or private reports of information relevant to tax liability. Information gathering occurs *before* assessment, levy, or collection and includes private reporting of information used to determine tax liability. Accordingly, the Court found that the TIA "is keyed to the acts of assessment, levy, and collection themselves, and enforcement of the notice and reporting requirements is none of these."

Notice and reporting law does not 'restrain' assessment, levy, or collection of tax

The Tenth Circuit adopted a broad definition of 'restrain' to include actions that would "limit, restrict, or hold back" the Department's sales tax collection efforts.

The Court disagreed with such a broad definition. Rather, it applied the more narrow meaning that would capture only those actions that would stop or enjoin acts of assessment, levy, and collection. Accordingly, the Court found that DMA's challenge did not 'restrain' the assessment, levy, or collection of Colorado's sales and use taxes merely because it may inhibit those activities.

The Court held that because "the TIA does not bar petitioner's suit, we reverse the judgment of the Court of Appeals."

Court takes no position on comity

The Court addressed a footnote in the Tenth Circuit's opinion stating that "[a]lthough we remand to dismiss [petitioner's] claims pursuant to the TIA, we note that the doctrine of comity also militates in favor of dismissal."

The Court acknowledged that under the 'comity doctrine,' federal courts refrain from interfering "with the fiscal operations of the state governments . . . in all cases where the Federal rights of the persons could otherwise be preserved unimpaired." Colorado did not seek comity from the lower courts below. The Court stated that it is up to the Tenth Circuit to "decide on remand whether the comity argument remains available to Colorado."

Justice Kennedy's concurrence advocates reexamination of Quill and Bellas Hess

While acknowledging that the instant case does not raise an issue regarding the physical presence nexus requirement stated in *Quill v. North Dakota*, Justice Kennedy wrote in a concurrence that this case provides "the means to note the importance of reconsidering doubtful authority. The legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess*."

Justice Kennedy noted that the *Quill* Court should have reevaluated the sales and use tax physical presence requirement "in view of the dramatic technological and social changes that had taken place in our increasingly interconnected economy. There is a powerful case to be made that a retailer doing extensive business within a State has a sufficient 'substantial nexus' to justify imposing some minor tax-collection duty, even if that business is done through mail or the Internet."

Kennedy went on to say that "[g]iven these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier. It should be left in place only if a powerful showing can be made that its rational is still correct."

The takeaway

The next phase of litigation in this case now resides with the Tenth Circuit Court of Appeals. The Supreme Court reversed the Tenth Circuit's decision that the TIA

precluded its review of the matter. However, the Tenth Circuit's footnoted mention of comity may suggest that the court could apply that doctrine in future proceedings to dismiss the case. The Supreme Court acknowledged this possibility by stating that the Tenth Circuit may decide the applicability of comity on remand.

Proceedings in state court continue. DMA filed a lawsuit in Colorado state court challenging the notice and reporting law. On November 5, 2013, DMA requested an injunction and on February 18, 2014, a district court judge granted the injunction. Click here for our summary of the state court action.

Justice Kennedy's concurrence is a rare expression by a member of the US Supreme Court that the Court would welcome a reexamination of the sales and use tax physical presence standard. Notably, no other justice joined in Kennedy's concurrence. It remains unknown what the Court would do should a challenge to *Quill* present itself before the Court.

Let's talk

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