United States Supreme Court to Review Ruling in *Direct Marketing*

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On July 1, 2014, the United States Supreme Court agreed to review the 10th Circuit Court of Appeals decision in Direct Marketing Association v. Brohl.[1] *The Court of Appeals held that federal courts lack jurisdiction under the Tax Injunction Act ("TIA") to address Direct Marketing Association's ("DMA") challenge to Colorado's use tax notice and reporting provisions.*

Colorado's use tax notice and reporting provisions are imposed on retailers with no physical presence in Colorado who do not collect use tax from Colorado purchasers. These provisions require such retailers to (1) provide transactional notices to Colorado purchasers, (2) send annual purchase summaries to Colorado customers, and (3) annually report Colorado purchaser information to the State.[2]

DMA filed suit in federal district court to challenge Colorado's notice and reporting provisions, alleging that they violate the Commerce Clause of the United States Constitution. The district court agreed with DMA because the notice and reporting provisions are imposed on retailers with no physical presence in Colorado in direct violation of the Supreme Court's holding in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).[3]

On appeal of the district court's ruling, the 10th Circuit did not address the merits of the Commerce Clause issue because it found that the TIA divested the district court of jurisdiction over DMA's Commerce Clause claims, and also noted that the doctrine of comity provided an additional basis for its ruling.

It is highly unlikely that the Supreme Court will revisit the physical presence substantial nexus standard set forth in *Quill in Direct Marketing* since the 10th Circuit decision did not address that issue, and instead focused solely on the jurisdictional issue.

[1] 735 F.3d 904 (10th Cir. 2013).

[2] Colo. Rev. Stat. § 39-21-112(3.5).

[3] *The Direct Marketing Association v. Roxy Huber*, No. 10-cv-01546-REB-CBS (D. Colo. Mar. 30, 2012).

While identifying the reason or reasons the Supreme Court granted review of this case is speculative, the Court may be interested in addressing some of the following conclusions reached by the 10th Circuit regarding federal court jurisdiction to hear state tax cases:

Are non-taxpayer parties precluded from litigating state tax cases in federal courts under the TIA?

DMA is not a Colorado taxpayer that is directly impacted by the state's notice and reporting provisions, but rather an association of interested persons so impacted. The 10th Circuit found the TIA applicable to non-taxpayer suits based on its interpretation of *Hibbs v. Winn*,[4] even though the Supreme Court in *Hibbs* found that the TIA did not apply.[5]

Do the Colorado notice and reporting provisions involve the assessment, levy or collection of a state tax that a federal court may not enjoin, suspend or restrain?

The 10th Circuit found the Colorado notice and reporting provisions do not impose a tax, but are mechanisms to collect use tax, and such a collection mechanism cannot be restrained by federal courts under the TIA. The 10th Circuit acknowledged that the Colorado notice and reporting provisions were unlike other TIA cases, and the cases cited in support of its conclusions involved plaintiffs concerned with the administration, collection or calculation of their own state taxes, and not the taxes of others. The Supreme Court may want to clarify its statement in *Hibbs* that the TIA is not a sweeping congressional directive to prevent federal court interference with all aspects of state tax administration.

Does the ability to file a suit for refund in state court constitute a plain, speedy, and efficient remedy for out-of-state vendors to contest the Colorado notice and reporting provisions?

Hibbs stated that a plain, speedy, and efficient remedy requires something more than the ability of an aggrieved taxpayer to file suit in state court, but rather a "tailor-made" remedy for taxpayers. The 10th Circuit found such a "tailor-made" remedy available in Colorado since out-of-state vendors could collect the use tax, file a refund claim with the Colorado Department of Revenue ("Department"), then, if the refund claim is denied, file a suit for refund in state court. Alternatively, the 10th Circuit found that such a taxpayer could refuse to comply with the notice and reporting provisions, contest any non-compliance penalties within the Department, and file a suit in state court to contest the penalties if the Department refused to abate them. The Supreme Court may wish to address whether the remedies referred to by the 10th Circuit are consistent with its decision in *Hibbs*.

When does the comity doctrine apply to deny access to federal courts to challenge state tax laws?

In a footnote, the 10th Circuit stated that the doctrine of comity was an alternative basis for denying federal court jurisdiction, citing *Levin v. Commerce Energy*.[6] Levin found that the comity doctrine provides a broader basis than the TIA to deny access to federal courts in state tax cases, and is intended to prevent federal courts from disrupting state tax administration. The Supreme Court may wish to address the scope of comity in state tax cases.

[4] 542 U.S. 88 (2004).

[5] In *Hibbs*, the Supreme Court found the TIA did not bar plaintiffs from filing suit in federal court to challenge the constitutionality of an Arizona tax credit relating to religious school tuition payments. The 10th Circuit distinguished the facts in *Hibbs* because, unlike the Colorado notice and reporting provisions, a tax credit does not operate to reduce the flow of state revenues – a factor the 10th Circuit believed was significant in *Hibbs*.

[6] 560 US 413 (2010). In *Levin*, the Supreme Court held that the comity doctrine precluded a federal district court from hearing a case involving the state taxation of the plaintiffs' competitors, and thus concluded that it need not rule on the applicability of the TIA.

Concluding Remarks

It is very difficult to gain access to federal courts to litigate a state tax case. Courts have relied upon a variety of theories to keep state tax cases out of federal court, including the TIA, comity, abstention, and the Eleventh Amendment to the United States Constitution. Refund suits, injunctive actions, declaratory relief actions, among others, are generally prohibited in federal court if the state offers a plain, speedy, and efficient remedy. While it remains to be seen how the Supreme Court will rule in *Direct Marketing*, it is highly unlikely that the doors to federal courts for litigants seeking to challenge state taxes will be opened widely.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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