



To: Brian Hamer, Hearing Officer
From: Helen Hecht, General Counsel, Multistate Tax Commission
Date: June 14, 2018
Subject: Staff Report – Upon Referral to Public Hearing of the Proposed Model Sales and Use Tax Notice and Reporting Statute

Background

The proposed model statute that is the subject of today’s hearing has been in the works for eight years. It was originally based on Colorado’s sales and use tax notice and information reporting statute, enacted in February, 2010 (the Colorado act).¹ That statute aimed to help Colorado collect the use tax owed by instate purchasers on purchases made from “remote” sellers (those without physical presence).

The primary goal of the statute was to ensure that both purchasers and the state had information from sellers, without which the correct amount of tax cannot be determined, and that purchasers have sufficient notice that they have incurred a tax obligation. But a secondary goal was to mitigate the unfair competitive advantage that remote sellers might otherwise receive if the state is, effectively, unable to collect tax due on their transactions with instate purchasers. Recognizing the need for such a law, the Commission’s uniformity committee, within a few weeks, took up the drafting of a model statute along the same lines.

But in August of 2010, the Direct Marketing Association (DMA) filed suit in federal district court challenging the Colorado act and seeking an injunction against the state. In its complaint, the DMA contended the Colorado act was constitutionally defective on a number of grounds, alleging, among other things, that it interfered with individual rights to privacy and free speech and that it violated the dormant commerce clause. All but the dormant commerce clause claims were eventually dropped.

Those remaining dormant commerce clause claims can be summarized as follows: (1) that requiring remote sellers to comply with notice and reporting requirements, while sellers with physical presence (who collected the tax) were exempt from those requirements, discriminated against interstate commerce, and (2) that requiring remote sellers to report information to purchasers with whom they were transacting sales, and to the state, violated *Quill’s* physical presence standard.

¹ Colo. Rev. Stat. §§ 39-26-104.



In January 2011, the federal district court issued a preliminary injunction in January 2011, preventing Colorado from implementing the requirements, and proceeded to take briefing on summary judgment motions. On March 2, 2011, while the federal case was still pending, the uniformity committee voted to recommend its own model statute to the Commission's executive committee. The executive committee, at its meeting on April 11, 2011, voted to submit the model to a public hearing pursuant to the Commission's bylaws. A hearing was held on May 18, 2011 and a report was provided back to the committee at its meeting on June 6, 2011.² The Hearing Officer, Shirley Sicilian, considered the constitutional challenges and noted:

First, the Hearing Officer disagrees that either the Colorado statute or Commission proposal violates the Constitution. Second, there would be costs, as well as benefits, associated with waiting for this issue to be conclusively resolved. The hearing officer believes that when the magnitude and likelihood of both costs and benefits are considered, the analysis weighs in favor of proceeding with the proposal.

After reviewing the Hearing Officer's report, the executive committee voted to submit the model to a bylaw 7 survey, a necessary step before the Commission can consider adopting a uniformity recommendation. That bylaw 7 survey was circulated to the 17 affected member states on June 7, 2011. As of July 8, 2011, when notice of the Commission's agenda was required to be given, eight states had responded in the affirmative, four states had responded in the negative, one state had abstained, and four states had yet to respond. Therefore, the model could not be taken up by the Commission at its 2011 meeting. But, by the time the executive committee met on July 28, 2011, two additional affirmative responses were received. The executive committee determined it would take up the matter, again, at its December meeting.

At that meeting, the executive committee considered the proposal and noted the "blanks" for the threshold amount of sales necessary to exceed the de minimus and small seller exceptions in the subsections (d)(1) and (2) of that draft. These threshold amounts had been left blank to allow for the variations in market size in different states. The executive committee requested that the uniformity committee recommend minimum threshold amounts for the exceptions in (d)(1) and (d)(2) of the proposal. On February 21, 2012, the uniformity committee recommended a revised version of the model and recommended minimum thresholds to the "small seller" exception of \$200,000 and \$100,000 for the reporting and notice requirements respectively; and would add recommended minimum thresholds to the "de minimis exceptions of \$100,000 and \$50,000 for the reporting and notice requirements respectively.

² The hearing officer's report is available at:

http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Committee_and_Subcomhttp://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Committee_and_Subcommittees/June_6,_2011_Executive_Committee_Meeting/Hearing%20Officer%20Report%20with%20Exhibits.pdf.



But then, on March 30, 2012, before the executive committee could again meet, the federal district court ruled in favor of the DMA on summary judgment motions and granted a permanent injunction against Colorado, finding that the notice and reporting requirements were discriminatory and violated *Quill's* physical presence standard. Colorado appealed to the Tenth Circuit. When it met again on May 10, 2012, the executive committee decided to table any further action on the proposed model statute pending the final decision in the constitutional challenge, which was then styled *Direct Marketing Association v. Brohl*.

Rather than ruling on the merits, however, on August 20, 2013, the Tenth Circuit ruled *sua sponte* that the federal courts lacked subject matter jurisdiction over the case under the federal Tax Injunction Act.³ Subsequently, the DMA filed a complaint in Colorado district court, raising the same dormant commerce clause claims as in the federal action.⁴ And, on March 5, 2014, the DMA also filed a petition for certiorari in the U.S. Supreme Court. The Supreme Court granted that petition, July 1, 2014.

The sole question before the Supreme Court was whether the Tax Injunction Act barred federal court jurisdiction over the case. Ultimately, the Court held that it did not. *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (2015) (*Brohl II*). While the case did not raise the question of whether *Quill* applied, the Court did conclude that the Colorado act did not involve the “assessment, levy or collection” of a state tax under the Tax Injunction Act’s prohibition. *Brohl II*, 135 S. Ct. 1124, 1133 (2015). Also, Justice Kennedy issued a concurring opinion questioning *Quill* as a precedent generally. The matter was then remanded to the Tenth Circuit for further proceedings on the merits.

The Tenth Circuit took additional briefing and argument on the dormant commerce clause claims—whether the requirements discriminated against interstate commerce and whether they violated *Quill*. Then, on February 22, 2016, it held for Colorado, finding that the notice and information reporting requirements imposed on remote sellers were neither discriminatory nor subject to *Quill's* physical presence standard. *Direct Mktg. Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016) (*Brohl III*).

Following this loss, the DMA again petitioned the U.S. Supreme Court for certiorari to review the Tenth Circuit’s holding that the notice and information reporting requirements did not discriminate against interstate commerce. Notably, the DMA did not ask the Court to review the Tenth Circuit’s holding with respect to *Quill*. On October 3, 2016, Colorado filed a conditional cross-petition requesting the Court to address the

³ *Direct Mktg. Ass'n v. Brohl* (“*Brohl I*”), 735 F.3d 904, 906 (10th Cir. 2013); and 28 U.S.C. § 1341.

⁴ On February 18, 2014, the state district court granted DMA’s motion for preliminary injunction. *Direct Mktg. Ass'n v. Colo. Dep't of Revenue*, No. 13CV34855, at 1, 22-23 (Dist. Ct. Colo. Feb. 18, 2014) (unpublished).



Quill question, in the event it granted the DMA's petition.⁵ In December of 2016, the Supreme Court denied both petitions.

As evidenced by its support for Colorado, up to and including the state's conditional cross-petition before the Supreme Court, the Commission's consistent position has been that the notice and information reporting requirements do not violate the dormant commerce clause.⁶ While it is conceivable that other circuits or state courts might rule differently, if such challenges were brought in other states, one recent event lends some additional, albeit informal, support for the Tenth Circuit's decision. In the arguments in the *Wayfair* case, the justices were clearly aware of the Colorado case (which was also featured in the briefing) and while they referred to the requirements for notice and information reporting, as a means to enforce the collection of use tax, they did not suggest that there was any question as to the Tenth Circuit's holding. Instead, the justices appeared to accept that if the states could not require remote sellers to collect the tax (as argued by South Dakota in *Wayfair*), they would, instead, simply impose notice and information reporting requirements.

The Current Proposed Model

After the Supreme Court denied the petitions for certiorari to review *Brohl III*, the executive committee, at its meeting on December 15, 2016, asked the uniformity committee to review its model statute imposing notice and information reporting requirements, and make any necessary changes, for referral back to the executive committee. When the uniformity committee took up that referral at its meeting in March 2017, Commission staff presented a report which noted that three additional states had adopted notice and information reporting statutes and other states were looking at doing so. At that meeting, Phil Horwitz, of the Colorado Department of Revenue, agreed to head up a work group to review and suggest amendments to the model.

The work group began meeting in April 2017. It held periodic meetings by phone until January 2018. It made reports back to the uniformity committee at the meetings of that committee and made its final report on April 25, 2018.⁷ At that meeting, the work group recommended a revised draft model to the uniformity committee for approval and referral to the executive committee. The uniformity committee approved the model and the executive committee considered it at its meeting on April 26, 2018, where it approved the model for a second public hearing. The notice of that hearing, to be held on June 14, 2018, was provided by Commission staff more than 30 days

⁵ This was partly in response to the concurring opinion of Justice Kennedy and the belief that the case presented an ideal vehicle for overturning or limiting *Quill* since it would not represent a direct challenge to the Court's precedent.

⁶ Copies of the Commission's amicus briefs before the Tenth Circuit and Supreme Courts can be found on our website, here: <http://www.mtc.gov/Resources/Amicus-Briefs>.

⁷ An archive of the work groups agendas and materials, including drafts, is available here: <http://www.mtc.gov/Uniformity/Project-Teams/Model-SU-Notice-and-Reporting-Statute>.



prior to the hearing, on May 7, 2018, as required by Compact Art. IV and Commission bylaw 7. The executive director has designated Commission counsel, Brian Hamer as hearing officer.

Note that since the approval of the model by the uniformity committee, Phil Horwitz has retired from the Colorado Department of Revenue and the primary Commission staff for the work group, Sheldon Laskin, has also retired from his position of counsel to the Commission.

The major changes to the model, as proposed by the work group and agreed to by the uniformity committee, are:

- The addition of notice and information reporting requirements for marketplace facilitators;
- The addition of authority to require information from referrers;
- Clarification of when notices or information reporting are required by sellers or marketplace facilitators;
- Treatment of a sellers who may be affiliated or related;
- Provision for when notices to purchasers may be provided electronically;
- Specification of certain exceptions to notice and information reporting requirements;
- Sourcing of sales of digital goods; and
- Other definitions and modifications of terms as necessary.

Enactments

As is often the case when the Commission's process for adopting recommendations of uniform models is delayed, states may proceed to enact or adopt a proposed model, in some form, before the Commission gives its final approval. The following states have now enacted some form of use tax notice and information reporting requirements: Alabama, Colorado, Georgia, Kentucky, Louisiana, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Vermont, and Washington.

Other Related Developments

The U.S. Supreme Court is expected to issue a decision in the *Wayfair* case in the next few days. We hope, and expect, that the Court will see fit to overturn *Quill*. But whether it does, or does not, its decision is likely to affect the evaluation of the proposed model. If the Court overturns *Quill*, states may consider the necessary role of notice and information reporting to be lessened. If the Court sustains *Quill*, states may wish to consider whether marketplace tax collection and reporting requirements will be an essential tool in use tax enforcement.