PALEY ROTHMAN
ATTORNEYS AT LAW

Justice Kennedy Says Time to Re-examine Sales Tax Collection Requirement

By Ronald Dweck

Justice Kennedy Calls for the Supreme Court to Re-examine Whether States May Require Out-of-State Online Retailers to Collect Sales Tax

The U.S. Supreme Court in *Direct Marketing Association v. Brohl* reached a unanimous decision Tuesday (March 3, 2015), overturning a Court of Appeals ruling in connection with a Colorado law aimed at trying to collect use taxes resulting from sales by out-of-state retailers.

Many states would love to get tax revenue from the sales by out-of-state retailers, sometimes known as the "Amazon Tax." However, under the Commerce Clause of the U.S. Constitution, if a business does not have a physical presence in the state, that state cannot require a business to collect use taxes – which are the equivalent of sales taxes for out-of-state businesses. While the consumer is still supposed to pay the "use" tax, where the seller has not collected a sales tax, in fact, very few customers make those payments. Because of the amount of sales over the internet, the states are losing out on an enormous amount of tax revenue.

Background

To improve compliance by the consumer to pay the use tax, Colorado passed a law requiring noncollecting retailers to notify any Colorado customer of the State's sales and use tax requirement and to report tax-related information to those customers and the Colorado Department of Revenue.

The District Court agreed with the Direct Marketing Association (a trade group for online retailers) that the law violates the Commerce Clause and issued a permanent injunction, rendering the statute essentially unenforceable. The Tenth Circuit sent the case back to federal district court, ordering it to lift the permanent injunction on the grounds that its action violated the Tax Injunction Act ("TIA"). The TIA bars federal courts from getting bogged down in state tax matters. The Supreme Court ruled that the suit brought by the Direct Marketing Association was not barred by the TIA.

Invitation to Overturn Quill and Tax Sales by Online Retailers

However, it is Justice Kennedy's concurrence, rather than the opinion of the Court, that is causing anxiety in the business community. After acknowledging the correctness of the Court, **Justice Kennedy concurred to clarify his view that the time has come for the Court to allow the states to impose sales taxes directly on sales by online retailers. He invited the Court to overturn *Quill v. North Dakota*, which stands for the proposition that a state may not require retailers who lack a physical presence in the state to collect these taxes.** He points out that a powerful case can be made that a retailer is doing extensive business in the state and has sufficient nexus to impose tax collection, even if that business is done through the internet.

Paley Rothman is closely monitoring the reinvigorated effort led by certain states and some brick-and-mortar retailers to mandate that online retailers collect sales taxes for all states, whether or not those retailers actually have a physical presence. The possibility that online businesses could be required to collect sales tax from every state has sparked arguments about the degree to which an internet sales tax mandate could make it significantly more difficult to start a new online business and place an onerous burden on many small business retailers. The call to immediately reconsider *Quill*, will undoubtedly cause many small online retailers to worry whether they will have the resources to deal with the attendant paperwork and compliance costs.

We invite you to check back on our site for additional information on *Direct Marketing Association* or to call us if you have questions.

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