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LEGAL ALERT

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Federal Court Grants Preliminary Injunction Against Colorado's Reporting Regime

On January 26, 2011, a U.S. District Court granted the Direct Marketing Association's (DMA) motion for a preliminary injunction preventing the state of Colorado from enforcing its recently enacted sales tax notice and reporting regime. *The Direct Marketing Association v. Roxy Huber*, Civil Case No. 10-cv-01546-REB-CBS, Order Granting Motion for Preliminary Injunction (U.S. Dist.Ct. Colorado, January 26, 2011). The DMA had filed its motion in August requesting an expedited hearing process to get a ruling before January 31, when the reporting requirements were scheduled to take effect.

The court concluded that the DMA had established the four elements required to obtain a preliminary injunction: (1) the plaintiff has a substantial likelihood of success on the merits, (2) the plaintiff has an irreparable injury, (3) the injury to the plaintiff outweighs the injury to the defendant, and (4) that the preliminary injunction is in the best interests of the public. The DMA's amended complaint asserted a number of grounds for relief, including violations of the Commerce Clause, the First Amendment, the Due Process Clause, and state privacy law.

Substantial Likelihood of Success on the Commerce Clause Claims

The DMA asserted two claims that the Colorado reporting regime violated the Commerce Clause: (1) the regime discriminates against out-of-state retailers, and (2) the regime imposes an undue burden on out-of-state retailers. The second claim relied heavily on the Supreme Court's decision in *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992).

First, the court determined that the impact of the regime was going to be felt only by out-of-state retailers, because in-state retailers are already required under other laws to collect and remit taxes. The court thus determined that, even though the statute did not target out-of-state retailers on its face, the DMA was likely to prevail that the statute was unconstitutionally discriminatory. The court also determined that there were other non-discriminatory methods to achieve the legislature's goal of collecting tax on sales by out-of-state retailers, specifically, the alternative method of having taxpayers remit use tax on personal income tax returns. Thus the court concluded that the DMA is likely to succeed on the merits that the statute is discriminatory, and that there are non-discriminatory alternatives available to achieve the state's goal.

Second, the court concluded that the DMA was likely to prevail on the claim that the regime violated the Commerce Clause because it imposed an undue burden on out-of-state retailers. The court analogized the regime to the unconstitutional imposition of use tax collection in *Quill*:

> Looking to the practical effect of the Act and the Regulations, I conclude that the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned in *Quill*. The Act and the Regulations impose these burdens on out-of-state retailers who have no connection with Colorado customers other than by common carrier or the United States mail. Those retailers likely are protected from such burdens on interstate commerce by the safe-harbor established in *Quill*.

Thus, the court concluded that the DMA had a substantial likelihood of successfully arguing that the Colorado requirements violate *Quill*'s physical presence nexus standard.

Irreparable Injury to the DMA

Having determined a substantial likelihood of success on the merits, the court then looked to whether the DMA was irreparably harmed without an injunction. The court concluded that there was irreparable harm for two reasons: (1) a recent 10th U.S. Circuit Court of Appeals case (in dicta) indicated that the violation of rights under the Commerce Clause constitutes irreparable injury, and (2) the DMA members would be liable for compliance costs, and would be prohibited under the 11th Amendment from suing the state to recover those costs.

Balance of Harm and Public Interest

Finally, the court concluded that the third and fourth prongs of the preliminary injunction test (the balance of harm favors the plaintiff and the injunction promotes the public interest) were met. The court held that the harm to the DMA outweighs the harm to the Department, because while the Department may experience some delay in collecting its taxes with an injunction, without an injunction, the DMA members would be liable for costs that they could not recover. Further, without an injunction, the Department may be enforcing an unconstitutional law – the prohibition of which is in the public interest.

Conclusion

The injunction is the latest twist in the ongoing narrative of the post-*Quill* story. Many states have been seeking legislation to restrict *Quill*'s physical presence test (or at least make it less relevant). The District Court's decision may give legislators and departments of revenue pause.

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