MARCH 30, 2015

News Analysis: The Effect of *Direct Marketing Association*

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Summary by taxanalysts

In news analysis, Marie Sapirie explains why *Direct Marketing Association* is a key case for both federal and state tax jurisprudence.

The Supreme Court's opinion in *Direct Marketing Association v. Brohl*, No. 13-1032 (Mar. 3, 2015)  , is fundamentally a federal tax law decision wrapped in the trappings of a state tax dispute. The case directly addresses the application of the Tax Injunction Act (TIA), but it has important implications for Anti-Injunction Act (AIA) jurisprudence as well.

In *Direct Marketing Association*, the plaintiffs challenged Colorado's notice and reporting law for retailers that are not required to collect sales and use taxes because they lack a physical presence in the state. The case was important to online retailers because if Colorado had been successful, states would have been able to enlist retailers in assisting them in the collection of taxes on online purchases.

The effect of *Direct Marketing Association* is to make it easier for taxpayers to get into court to challenge regulations without having to go through the traditional refund suit proceedings, said Patrick J. Smith of Ivins, Phillips & Barker Chtd. "In other areas of federal law, the common way to challenge regulations is to file suit as soon as regulations are issued," he said. This decision opens up that possibility in the tax context, said Smith.

Similar Statutes

The AIA is designed to ensure the prompt collection of taxes by preventing taxpayers from bringing pre-enforcement lawsuits and to require the legal right to disputed amounts to be determined in refund suits. The AIA dates back to 1867, and it was the model for the TIA when it was enacted in 1937. However, the Supreme Court's jurisprudence on the AIA charted an unsteady course until its revival in the context of the Affordable Care Act challenges.

The similarity between the TIA and the AIA is important. The TIA states that federal district courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." The AIA is in section 7421(a) and states that "no suit for the purpose of

restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."

Tenth Circuit

The Tenth Circuit found that the district court lacked jurisdiction because 28 U.S.C. section 1341 barred the suit. The Tenth Circuit acknowledged that it was not a "prototypical TIA case," but determined that it "would limit, restrict, or hold back the state's chosen method of enforcing its tax laws and generating revenue" if successful (735 F.3d 904 (10th Cir. 2013)). The Supreme Court reversed.

The Tenth Circuit's discussion noted the parallel purposes and structures of the TIA and the AIA and examined its decision in *Hobby Lobby Stores, Inc. v. Sebelius*, 723 F.3d 1114 (10th Cir. 2013), which determined that the AIA was not applicable to a "purely regulatory tax" that was only a penalty for violating regulations. The court wrote that its decision to apply the TIA was consistent with the *Hobby Lobby* analysis. The Supreme Court in *NFIB v. Sebelius*, 132 S. Ct. 2566 (2012), held that the AIA did not bar a challenge to the constitutionality of the ACA's individual mandate provision because Congress did not call the penalty a tax or direct courts to apply the AIA.

The Tenth Circuit's analysis of the AIA puts too much emphasis on the Supreme Court's discussion of the AIA. Although the Supreme Court showed a willingness to depart from precedent that blindly applied the AIA to statutorily described "taxes" even where that label was inaccurate, the Court did not say that the AIA did not apply to penaltylike taxes, but rather that it was up to Congress whether a penalty should be subject to the AIA.

Supreme Court Decision

The decision in *Direct Marketing Association* narrows the application of the AIA. Smith said that *Direct Marketing Association* follows the decision in *Hibbs v. Winn*, 542 U.S. 88 (2004), but goes even further because it rejects the idea that a remote impact on tax collection or assessment is sufficient to trigger the TIA, and by extension, the AIA.

In *Hibbs*, the Supreme Court held that an establishment clause case challenging the granting of a state tax credit for contributions to school tuition organizations was not prohibited by the TIA. The Court's analysis focused on the meaning of the word "assessment" in the TIA, a word that is echoed in the AIA. In *Hibbs*, Justice Ruth Bader Ginsburg explained that "this Court has interpreted and applied the TIA only in cases Congress wrote the Act to address, *i.e.*, cases in which state taxpayers seek federal-court orders enabling them to avoid paying state taxes."

The divergence between the majority and the dissenters in *Hibbs* is echoed in *Direct Marketing Association*. The decision in *Hibbs* emphasized that the Court's precedent had "state-revenue-protective moorings." Ginsburg framed the question in part as "whether the [TIA] was intended to insulate state tax laws from constitutional challenge in lower federal courts even when the suit would have no negative impact on tax collection." That emphasis on state revenue is reflected in Ginsburg's concurrence in *Direct Marketing Association*, in which she observed that "the Direct Marketing Association is not challenging its own or

anyone else's tax liability or tax collection responsibilities." With the exception of Chief Justice John G. Roberts Jr., who was not on the Court in 2004, the justices who dissented in *Hibbs* joined the majority in *Direct Marketing Association*.

In contrast to the strict focus on the fisc espoused by the majority, Justice Anthony M. Kennedy explained in the dissent that the TIA should be a bar to the suit because "to order the Director not to record on the State's tax rolls taxpayer liability that reflects the operation of [the statute] (or any other state tax law provision for that matter) would be to bar the Director from recording the correct taxpayer liability." The dissent further stated that the Court's precedent made it clear that the purpose of the TIA is not only to protect state revenues by requiring taxpayers to pay first and then seek a refund, but also to protect the tax system administration and tax policy implementation of the states.

In *Direct Marketing Association*, Justice Clarence Thomas noted that, according to legislative history, assessment is the step in the taxation process that occurs after reporting information regarding tax liability. Thomas examined the definitions of levy and collection and determined that information reporting was not included in them because the reporting step comes before both assessment and collection.

Kennedy joined the opinion in *Direct Marketing Association*, and Thomas favorably cited the dissent in *Hibbs* for the proposition that the word "restrain" in the TIA should be narrowly interpreted. The limiting of the TIA to cases that directly affect assessment, levy, or collection is a narrow holding, but one that has potentially expansive repercussions for challenges to tax regulations.

Florida Bankers Association

Smith said the decision in *Direct Marketing Association* will have an immediate impact in cases like *Florida Bankers Association v. Treasury*, No. 1:13-cv-00529 (D.D.C. 2014). "To the extent that the decision makes it harder for the government to file motions to dismiss in [cases that challenge regulations without first going through the normal tax litigation mechanisms], this will clearly be an important case," he said. The plaintiffs in *Florida Bankers Association* challenged regulations requiring U.S. financial institutions to report interest paid to some nonresident aliens under the Administrative Procedure Act. An appeal is pending in the D.C. Circuit. (Prior coverage: *Tax Notes*, Feb. 23, 2015, p. 955 .)

At oral arguments in the case, District Court Judge Brett M. Kavanaugh said that the AIA might apply as a bar to the suit. Counsel for the bankers associations responded that the penalty in subchapter 68B is not a tax, but Kavanaugh disagreed. In response to Kavanaugh's questioning, the government's counsel said that a bank might not lawfully be able to decide to pay the penalty instead of reporting the information. Kavanaugh said he thought that answer was problematic under the AIA.

The exchange between the attorneys and Kavanaugh is significant because the case also involves reporting requirements. The attorneys for the Florida Bankers Association submitted a letter to the D.C. Circuit arguing that the Supreme Court's explanation that the federal tax code and the TIA treat reporting requirements as separate and distinct from the

"assessment and collection" of a tax is identical to their challenge to the interest reporting requirements.

The government responded that the "plaintiffs' bid for injunctive relief against the enforcement of a Treasury Regulation requiring U.S. banks to report interest paid to nonresident aliens is nonetheless barred by the AIA." The government said that, in contrast to the reporting requirement in *Direct Marketing Association*, the association's lawsuit is meant to restrain the collection of tax because noncompliance with the requirement triggers a penalty that is treated as a tax under section 6671(a).

The Supreme Court's refusal to apply the TIA as a bar to the Direct Marketing Association's challenge to the reporting requirements represents another step toward a narrower view of the TIA and AIA than the Court has traditionally taken. This could result in an increase in the number of challenges to regulations.