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MEMORANDUM

TO: Sales and Use Tax Simplification Task Force

FROM: Jessica Herrera, Office of Legislative Legal Services

DATE: July 26, 2022

SUBJECT: Summary of the Complaint in Wayfair LLC v. City of Lakewood, Colorado et al¹

Factual Background

The case concerns a sales tax dispute between Wayfair LLC ("Wayfair"), a Delaware limited liability company based in Boston, Massachusetts, and the City of Lakewood, Colorado ("Lakewood"), a home rule city that imposes and collects sales tax. On October 20, 2021, Lakewood issued a Notice of Deficiency ("Notice") to Wayfair. The Notice asserts that Wayfair owes Lakewood \$604,322.17, which includes \$460,518.69 in sales tax owed for the tax period of May 2018 through May 2021 ("tax period"), \$46,051.87 in penalties, and \$97,751.61 in interest. Wayfair contends that it does not owe Lakewood any of the tax, penalties, or interest.

On October 21, 2021, Wayfair and Lakewood executed an agreement authorizing Wayfair to take its challenge to the Notice directly to the Executive Director of the Colorado Department of Revenue ("Executive Director"). On May 23, 2022, after further discussions, Wayfair and Lakewood signed a second agreement authorizing

¹ This legal memorandum results from a request made to the Office of Legislative Legal Services (OLLS), a staff agency of the General Assembly. OLLS legal memoranda do not represent an official legal position of the General Assembly or the State of Colorado and do not bind the members of the General Assembly. They are intended for use in the legislative process and as information to assist the members in the performance of their legislative duties.

Wayfair to take its challenge to the Notice directly to the District Court for Jefferson County, Colorado. On June 22, 2022, Wayfair filed a Complaint against Lakewood and the Executive Director challenging the Notice ("Complaint") in that court.²

Wayfair is a leading e-commerce retailer for home goods. According to the Complaint, Wayfair had no offices, employees, or representatives in Colorado until it opened a distribution facility in Aurora, Colorado in September 2017. Wayfair began employing drivers at that facility to make deliveries to Lakewood and other locations on July 16, 2018. Wayfair alleges that the vast majority of items that it sells to purchasers in Lakewood are delivered from out-of-state locations by a common carrier and that a small number of such items are delivered by Wayfair drivers from the Aurora facility.

During the tax period, Lakewood generally imposed a 3% sales tax on the retail sale of tangible personal property to persons located within its borders but imposed only a 1% sales tax on sales made within the Belmar district ("Belmar").³ Throughout the tax period, Lakewood required a retailer that was "engaged in business in the City", as defined in Lakewood's municipal code, to collect sales tax. Before January 16, 2021, Lakewood's definition of "engaged in business in the City" required a retailer to have some physical presence in Lakewood, but effective January 16, 2021, the definition was amended to include retailers who had only "economic nexus" with Lakewood.

Summary of the Complaint

The complaint generally alleges that Lakewood's attempt to collect sales tax from Wayfair for retail sales made by Wayfair during the tax period violates the Dormant Commerce Clause of the United States Constitution,⁴ which impliedly prohibits states and political subdivisions of states such as municipalities from discriminating against or unduly burdening interstate commerce. The Complaint includes four specific counts.

Count I asserts that requiring Wayfair to collect Lakewood's sales tax during the tax period imposes an undue burden on interstate commerce because neither Lakewood nor the Executive Director provided a single statewide system of tax administration for all state and local taxes. Wayfair notes that in Colorado 71 home

² *Wayfair LLC v. City of Lakewood et al.*, Case No. 2022CV30710.

³ Belmar is a geographical area within Lakewood within which public improvements are funded through a public improvement fee of 2.5% that is imposed on all retail sales by retailers located within Belmar.

⁴ U.S. Const., art. I, § 8, cl. 3

rule municipalities and numerous statutory counties and municipalities, regional transportation districts, and special districts impose sales taxes and contends that the lack of a single statewide system of tax administration for all state and local taxes forces retailers to "navigate these complex, overlapping, and competing obligations, [which] is an administrative nightmare, and an undue burden on interstate commerce." Wayfair also contends that Lakewood's and the Colorado Department of Revenue's inability to provide access to tax administration software paid for by Lakewood or the state that would, if used, immunize Wayfair or other retailers from audit liability for any errors failed "to provide adequate safeguards and support for out-of-state retailers...".

Count II asserts that the application of the Lakewood sales tax to Wayfair discriminates against interstate retailers in violation of the Dormant Commerce Clause of the United States Constitution by imposing additional obligations for out-of-state retailers in at least the following ways:

- (1) "Treating them differently from retailers physically located in the Belmar district who were authorized to charge a lower rate of tax.";
- (2) "Applying a different sourcing rule to their sales than applied to sales by businesses located in the City. While a business located in the City could treat a sale it made as sourced to its physical location, a business like Wayfair, that made online sales from outside of the State was required to source those sales to the City, not the location from which they were made."; and
- (3) "... For periods after January 16, 2021, applying a definition of 'Engaged in Business' that treats out-of-state retailers differently from similarly situated in-state retailers, i.e., retailers based in Colorado but not physically present in Lakewood."

Count III asserts that Wayfair was not "engaged in Business" in Lakewood under either the holding of *Associated Dry Goods Corp. v. City of Arvada*, 197 Colo. 491 (1979), which specified that "delivery alone is an insufficient nexus" for the imposition of an obligation to collect sales tax on a retailer, or, before January 16, 2021, under the Lakewood city ordinance that remained in effect until January 16, 2021, and that defined "engaged in business in the City" in a manner that required some physical presence in Lakewood.

Count IV asserts that Wayfair lacked substantial nexus with Lakewood under the former governing "physical presence" legal standard for determining whether a state or municipality could impose sales tax collection and remittance obligations on an out-of-state business as set out in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *National Bellas Hess, Inc. v. Ill. Dep't of Revenue*, 386 U.S. 753, 759-60 (1967), and *Quill*

Corp. v. North Dakota, 504 U.S 298 (1992) that applied for the time period of May 1, 2018 to June 21, 2018, when the United States Supreme Court overturned *Quill* and *National Bellas Hess* in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).