BY MARY KAY MARTIRE, MATTHEW C. BOCH AND LAUREN A. FERRANTE

MULTISTATE

Damned if You Collect, Damned if You Don't: Retailers Caught Between Consumer Class Action and *Qui Tam* Claims

Third party tax enforcement lawsuits against retailers have multiplied over the past decade.[1] The growth of these suits puts retailers that are faced with complex or uncertain tax issues in an untenable position. If they collect a transaction tax, they run the risk of consumer class action litigation alleging over-collection. On the other hand, if they do not collect the tax, they face the possibility of third party *qui tam* whistleblower claims. The trend is troubling, particularly given the size and breadth of claims filed this year.

One such scenario is playing out in the realm of state sales tax on shipping and handling charges. A proposed class action lawsuit has been filed against Papa John's International, Inc., in Florida, alleging that Papa John's unlawfully collected sales tax on its pizza delivery charges. The proposed class seeks a monetary refund from Papa John's.[2] Papa John's responded to the litigation by removing the case to federal court and moving to dismiss. Papa John's motion relied on a Florida statute that expressly limits consumer class recovery claims of overcollection to amounts not remitted to the state.[3]

In an opinion issued on July 23, 2014, the Florida district court denied Papa John's motion on the basis that Papa John's claims were affirmative defenses and thus "premature."[4] The court's decision to allow the case to proceed despite what appears to be a strong statutory defense is an unfortunate turn of events, as it burdens Papa John's with additional litigation defense costs, including discovery and the likely expense of filing a summary judgment motion. The failure to dismiss also serves to undermine the public policy behind such statutes, which commonly are understood to encourage retailers to err on the side of tax collection as long as the amounts collected are remitted to the state.

Similar claims were filed against Papa John's in Madison County, Illinois.[5] The Illinois lawsuit faces an additional hurdle: a 2009 Illinois Supreme Court decision affirming the dismissal of a proposed class action lawsuit challenging another retailer's collection of tax on its shipping and handling charges.[6] In *Kean v. Wal-Mart Stores,* the Illinois Supreme Court held that shipping charges (normally a non-taxable service) were taxable when they were inextricably linked to the sale of tangible personal property. The court concluded that under the facts presented, shipping charges were inextricably tied to the sale of goods because Wal-Mart's customers had no option of free shipping or in-store pick up. In its Illinois complaint against Papa John's, the proposed class asserts that Papa John's delivery charges are not tied to its pizza sales and therefore are not taxable because customers have the option to pick up their pizzas, thereby avoiding any delivery charge.[7]

Just as in Florida, Papa John's has removed the Illinois complaint to federal court and filed a motion to dismiss.[8] In its motion, Papa John's argues that the class cannot recover tax remitted over to the state, and that the voluntary payment doctrine also bars recovery. The court must rule on a motion to remand before any motion to dismiss may be considered.

The growth of third party tax enforcement lawsuits puts retailers that are faced with complex or uncertain tax issues in an untenable position.

Adding fuel to the fire, an Illinois law firm has filed upwards of 150 lawsuits under the Illinois False Claims Act as a "whistleblower" against retailers that do not collect Illinois use tax on the shipping and handling charges associated with their Internet or catalog sales. These are *qui tam* actions in which a private party, termed the relator, sues on behalf of the government seeking recovery against fraud or similar wrongdoing that has injured the government.

The editors of The Journal of Multistate Taxation and Incentives *feature this column as a forum for discussing important multistate tax issues. We invite inquiries from our readers, either commenting on articles or columns in* The Journal *or sharing ideas and experiences with other readers. Inquiries should be sent to the managing editor at daniel.schibley@thomsonreuters.com. This month's column was contributed by Mary Kay Martire, a partner, and Matthew C. Boch and Lauren A. Ferrante, associates, in the Chicago office of the law firm of McDermott Will & Emery LLP.*

Citing *Kean*, the lawsuits allege that the retailers "knowingly" failed to collect the tax and seek treble damages, attorneys' fees and associated penalties. The lawsuits were filed without regard to whether the retailers had been audited and found not to owe tax on their shipping and handling charges, and cite no facts other than *Kean* to support the allegation of a knowing violation of the tax law.

The Illinois Attorney General has declined to intervene in these cases, permitting the relator to proceed with the prosecution on its own. To date, the trial court has refused to dismiss most of the lawsuits on the grounds that they raise a fact dispute. Because the amounts at issue frequently are very small (6.25% tax on shipping and handling charges), the lawsuits force many retailers into the nuisance suit analysis of choosing between paying an (entirely undeserved) settlement to resolve the litigation or bearing the expense of discovery, summary judgment and/or trial. The Illinois General Assembly has failed to act on a corrective bill that would make such lawsuits more difficult to file.[9]

Illinois is not the only state that permits the filing of *qui tam* actions in the state tax arena. Seven states (Delaware, Florida, Nevada, New Hampshire, New York, Washington, and Wisconsin) permit state tax false claims actions involving any type of tax.[10] Three others (Illinois, Indiana, and Rhode Island) bar only income tax false claims actions; any other type of state or local tax is fair game.[11]

The incidence of state tax false claims act litigation is on the rise. Within the past few months, two lawsuits have been unsealed (in Delaware and New York) by "whistleblowers" alleging state tax violations.[12] The dollars allegedly involved in each matter are significant. Even more troubling, the lawsuits step outside the transaction tax arena, alleging, in one case, the failure to remit unclaimed property, and in the other, a failure to pay corporate income tax.

> The incidence of state tax false claims act litigation is on the rise.

Fortunately, the problem of third-party state and local tax litigation is not universal. Some state attorneys general, when faced with this type of litigation, have concluded that state tax investigations are more properly handled by existing state departments of revenue. These states recognize the substantial investigative powers already provided to state departments of revenue to ferret out and punish tax scofflaws. Furthermore, they understand the risks inherent in permitting tax enforcement actions to be carried on by third party litigants with little or no tax experience.

In response to tax-based whistleblower claims filed by the same law firm responsible for the Illinois *qui tam* litigation, the Tennessee attorney general intervened and successfully moved to dismiss the litigation. Tennessee then amended its false claims act to prevent its use in state tax matters.[13] Nevada's attorney general also intervened and moved to dismiss similar tax-based false claims litigation.[14]

In another positive development, the California Supreme Court recently held, in *Loeffler v. Target Corp.*, No. S173972 (Cal. May 1, 2014), that consumers were precluded from bringing actions based on consumer fraud statutes, where consumers sought refunds of sales tax reimbursement previously paid and an injunction against future collections. The court reasoned, in part, that the state tax code provides the exclusive means by which to dispute the taxability of a retail sale. *See id.* at 17 ("[I]t would be inconsistent with this scheme to permit the consumer to initiate a consumer action such as plaintiffs' requiring a court to resolve, outside the searching regulatory scheme established by the tax code, whether a sale was taxable or exempt ....")

Both the Multistate Tax Commission and the American Bar Association are working to resolve the issues faced by retailers with respect to third party enforcement tax administration. The ABA has adopted model legislation that would limit the rights of purchasers to bring over-collection of tax claims against retailers.[15] The MTC has formed a joint state/industry work group to examine the issues involved in tax-related third party class action suits and false claims act suits.[16] Hopefully these efforts will provide retailers with additional weapons to defend against third party tax claims. ■

1 *See* Multistate Tax Commission, Memorandum regarding survey of class action refund claims and false action claims, dated July 12, 2013 (describing such actions), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Committee_and_Subcommittees/46th_Annual_Conf/Class%20Action%20and%20FCA%20Survey%20(July%2012,%202013).pdf (last visited Aug. 4, 2014).

2 Compl., *Schojan v. Papa John's Int'l, Inc.*, No. 14-CA-003491 (Circuit Court Hillsboro County, Florida Apr. 3, 2014).

3 *See* Mot. To Dismiss, *Schojan*, No. 8:14-cv-1218-T-33MAP, at 4-11 (M.D. Fla. June 13, 2014).

4 *See* Order, *Schojan*, No. 8:14-cv-1218-T-33MAP, at 6-7, 10-11 (M.D. Fla. July 23, 2014).

5 *See* Compl., *Tucker* v. *Papa John's Int'l, Inc.*, No. 3:14-cv-00618-NJR-PMF (S.D. Ill May 29, 2014) (as removed from No. 2014-L-000668 (3d Jud. Cir. Ill., Madison Cty. May 5, 2014)).

6 *Kean v. Wal-Mart Stores, Inc.*, 919 N.E.2d 926, 235 Ill. 2d 351 (2009).

7 *See* Compl., *Tucker*, No. 3:14-cv-00618-NJR-PMF, at ¶ ¶ 14-15.

8 Mot. To Dismiss, *Tucker*, No. 3:14-cv-00618-NJR-PMF (S.D. Ill. July 11, 2014); Mot. To Remand, *Tucker*, No. 3:14-cv-00618-NJR-PMF (S.D. Ill. June 27, 2014).

9 *See* H.B. 0074, 98th Gen. Assem. (Ill. 2013).

10 Del. Code Ann. tit. 6, § § 1201-1211; Fla. Stat. § § 68.081-68.09; N.H. Rev. Stat. Ann. § § 167:61-b to 167:61-e; Nev. Rev. Stat. § § 357.010-357.250; N.Y. State Fin. Law § § 187-194; Wash. Rev. Code § § 74.66.020, 74.09.201-74.09.214; Wis. Stat. § § 20.931, 71.83(2)(b)4.

11 740 Ill. Comp. Stat. 175/3(c); Ind. Code § 5-11-5.5-2(a); R.I. Gen. Laws § 9-1.1-3(d).

12 In Delaware, the *qui tam* lawsuit alleges that over 15 retailers "schemed to deprive the State of Delaware of hundreds of millions of dollars due to the State under the Abandoned Property Law...." Compl., *State of Del. v. Card Compliant, LLC*, No. N13C-06-289 (FS) (Del. Sup. Ct., New Castle County June 28, 2013). A motion to dismiss is pending in federal court following removal. Mot. To Dismiss, *Card Compliant, LLC*, C.A. No. 14-CV-688-GMS (D. Del. July 31, 2014).

13 Tennessee amended its false claims act to provide that it does not apply to any state-administered taxes (Tenn. Code Ann. section 4-18-103(f)), following false claims act litigation filed by the same law firm responsible for filing the Illinois litigation (*State of Tenn. ex rel. Beeler, Schad & Diamond P.C. v. Target Corp.*, No. 02-3763-III (Tenn. Chancery Ct. Dec. 1, 2003)).

14 *Int'l Game Tech., Inc. v. Second Judicial Dist. Court of the State of Nev.*, 127 P.3d 1088 (Nev. 2006).

15 *See* American Bar Association, Section of Taxation, Report to the House of Delegates, Resolution, http://www.americanbar.org/content/dam/aba/administrative/taxation/policy_resolution_with_report_model_model_transactional_tax_overpayment_act.authcheckdam.pdf (last visited Aug. 4, 2014).

16 *See* Multistate Tax Commission, http://www.mtc.gov/Uniformity.aspx?id=6088 (last visited Aug. 4, 2014).