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Illinois Appellate Court Blows Whistle On Whistleblower Suit For Use Taxes

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The Illinois appellate court in *The State ex rel. Beeler, Schad and Diamond, P.C. v. Burlington Coat Factory Warehouse Corporation and Burlington Coat Factory Direct Corporation* (No. 1-05-3824, Dec. 6, 2006), affirmed the trial court's decision to dismiss an action under Illinois' whistleblower statute involving state use taxes. By this ruling, the appellate court recognized even broader power by the Attorney General to dismiss the whistleblower suit, over the private whistleblower's objection, than the circuit court had outlined in its ruling.

Background

The Illinois Whistleblower Statute.

Under the Illinois Whistleblower Reward and Protection Act (the "Whistleblower Act"), a private person (referred to as a "relator") may bring a civil action in the name of the state against a person for defrauding the state. Such an action is sometimes referred to as a "*qui tam*" action.

Once a relator files a *qui tam* action, the state may intervene, proceed with the action and take over conduct of the action. Alternatively, the state may decline to intervene, thus giving the relator the right to conduct the action. A relator is considered a party to the action and, if a suit is successful, is awarded a percentage of the proceeds or settlement.

The Whistleblower Act specifically provides that the state may dismiss a *qui tam* action notwithstanding the objections of the relator, if the relator has been notified by the state of the filing of the motion to dismiss and the court has provided the relator an opportunity for a hearing on the motion.¹

Plaintiffs' Firm Files Multitude Qui Tam Suits.

A plaintiffs' firm, Beeler, Schad and Diamond, P.C. ("BSD"), has brought *qui tam* actions under the Whistleblower Act against over eighty out-of-state retailers, alleging that they failed to collect and remit Illinois use taxes on internet sales. Most of these retailers had

¹ 740 ILS 175/4(c)(2)(A).

formed separate subsidiaries to make internet sales and took the position that their subsidiaries were not required to collect Illinois use tax on internet sales to Illinois customers because they did not maintain a place of business in Illinois, and therefore did not have the requisite nexus to Illinois.

In 2003, the Illinois Attorney General decided to intervene in a number of these suits. After the state took over, some of the retailers reached confidential settlements with the state. However, a large number of the retailers joined forces and filed a joint motion to dismiss the complaints on several legal grounds common to all defendants. The circuit court denied the motion but certified its ruling for immediate appeal.

Although the appellate court initially declined to accept the certification of this interlocutory appeal, the Illinois Supreme Court, at the defendants' request, ordered the appellate court to proceed with hearing the appeal. The briefing of this appeal was completed this month and the matter is pending as *State of Illinois, ex rel. Beeler, Schad & Diamond, P.C. v. Ritz Camera Centers, Inc., et. al.*, No. 1-05-1059, awaiting for oral argument to be scheduled.

Some other retailers chose to resolve these suits separately – including Burlington Coat Factory Warehouse Corporation (“Burlington”) and its subsidiary, Burlington Coat Factory Direct Corporation (“Burlington Direct”).

The Burlington Qui Tam Suit.

Burlington sells its wares through 19 stores located in Illinois. Its subsidiary, Burlington Direct, makes sales to customers (including customers in Illinois) through its website and does not collect or remit Illinois use tax on those sales. In the *qui tam* suit against Burlington and Burlington Direct, BSD alleged that Burlington and Burlington Direct knowingly made false claims about their use tax liability in violation of the Whistleblower Act and contended that Burlington Direct had a duty to collect and remit use taxes because it maintained a place of business in Illinois through the stores owned and operated in Illinois by its parent, Burlington.

After intervening in the action against Burlington and Burlington Direct, the state moved for dismissal, asserting that there was probably not a sufficient nexus with Illinois under the Commerce Clause to require Burlington Direct to collect use tax on sales to customers. The Illinois circuit court granted the motion. BSD appealed.

The Burlington Lower Court's Decision.

While providing that the state may dismiss a *qui tam* action “notwithstanding the objections of the [relator]” if the relator has been notified by the state of the filing of the motion to dismiss and the court has provided the relator an opportunity for a hearing on the motion, the Whistleblower Act does not specify the court's role during the hearing. The Whistleblower Act is also silent as to what the court should consider during the hearing or whether the court even has the power to deny the state's request for dismissal of an action.

The circuit court determined that the Whistleblower Act's silence did not give the state unfettered discretion to dismiss a *qui tam* action. Looking to the federal courts' interpretation of the federal whistleblower statute, which served as the model for the Illinois statute, the circuit court concluded that the state's motion to dismiss should be granted if the two-part test set forth in *United States ex rel. Sequoia Orange Co. v. Baird-Neece Packing Corp.*² was satisfied. Under this two-part test, the government must first identify a valid governmental purpose for the dismissal and then show a rational relation between dismissal and accomplishment of that purpose. If this two-part test is satisfied, then the burden shifts to the relator to show that dismissal is fraudulent, arbitrary and capricious, or illegal. The circuit court here concluded that BSD failed to successfully rebut the reasons advanced by the state and granted the state's motion to dismiss.

The Appellate Court's Analysis.

Looking to the Whistleblower Act as a whole, the appellate court observed that the state has complete control over a *qui tam* action and gives the state almost unlimited discretion to voluntarily dismiss such an action. The court noted that if the state proceeds with a *qui tam* action, it has the primary responsibility for prosecuting the action and is not bound by the actions of the relator. In addition, the state can decide whether to prosecute the action or not. If the state chooses to intervene, the action is conducted by the state. Finally, the state can settle a *qui tam* action notwithstanding the objection of the relator if the court determined, after a hearing, that the proposed settlement is fair, adequate and reasonable under all the circumstances.

The appellate court ultimately concluded that the issue of whether to proceed with a *qui tam* action should be made by the executive branch and not by the courts. The appellate court concluded that if the state attorney general's decision to dismiss an action is subject to judicial review, the courts would have veto power over the attorney general's decision which is tantamount to usurping its power to direct the legal affairs of the state. The appellate court concluded that, absent evidence of fraud or bad faith by the state, the presumption is that the state is acting in good faith and it is the state's prerogative to decide which case to pursue. Since no bad faith or fraud was alleged by BSD, the appellate court affirmed the circuit court's dismissal of the action. BSD has petitioned for leave to appeal to the Illinois Supreme Court.

Conclusion

The appellate court's decision has not only clarified but also strengthened the Attorney General's ability to dismiss cases that the state, after further inquiry, concludes should not have been pursued as *qui tam* actions. This decision, however, does not address the fundamental issue of whether tax claims should be prosecuted through *qui tam* actions in the first instance. Unlike the federal whistleblower statute and most state whistleblower statutes, the Illinois Whistleblower Act does not specifically exclude use tax claims.

² 151 F.3d 1139 (9th Cir. 1998).

As argued by the defendants in the pending *Ritz Camera* appeal, *qui tam* actions for taxes are inappropriate for various reasons. *Qui tam* tax actions allow a private person, in this case a private plaintiffs' firm, to bring suits that deprive a taxpayer of its standard taxpayer rights under the Illinois tax statutes and attempt to usurp the Illinois Department of Revenue's authority to determine the tax questions raised. That issue, along with other issues, has been left for another day to be decided by the First Judicial District of the Illinois Appellate Court.

We will keep you informed as these cases proceed and are, hopefully, dismissed.■



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