

LEGAL UPDATES

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Service
Tax

Whistleblower Suits Seek to Collect Sales Tax on Delivery Charges for Internet Sales

Online retailers who sell to customers in Illinois should be aware that a large number of “whistleblower” lawsuits have been filed against Internet retailers for failing to collect and pay Illinois state sales tax on shipping and delivery charges. The recoveries associated with these violations are often very large, and similar claims might arise in other states. The potential risk to retailers that fail to collect the tax is severe. We encourage all online retailers to review their policies and procedures related to the collection of sales tax on delivery charges to ensure they are in compliance with all applicable state tax laws.

Background

In late 2009, the Illinois Supreme Court ruled that, contrary to prior guidance from the Illinois Department of Revenue, sales tax should apply to certain shipping and handling charges for internet purchases delivered in Illinois. In *Kean v. Wal Mart Stores*, an Internet customer sued Wal-Mart for charging sales tax on the cost to ship a trampoline for delivery in Illinois. The plaintiff claimed that the charge was improper because Illinois did not apply sales tax to shipping charges. Despite prior guidance from the Illinois Department of Revenue indicating that shipping costs were generally not subject to sales tax, the court ruled that the sales tax did apply to the purchase. The court explained that because the online purchaser was required to select and pay for some form of delivery, the delivery costs were part of the total purchase price for the product, and, therefore, subject to sales tax.

Whistleblower Law

Kean opened the door to numerous whistleblower lawsuits under the Illinois False Claims Act against retailers that failed to collect and remit Illinois sales

tax on shipping charges. The Illinois False Claim Act (FCA), a form of “qui tam” or “whistleblower” statute, allows a private individual to essentially act on behalf of the state and sue another private party for improper and fraudulent activity.

Not only does the statute permit the private right of action, but it creates an incentive to sue by rewarding the whistleblower with between 25 percent and 30 percent of the proceeds of a successful lawsuit, *plus* reasonable attorneys’ fees. In Illinois, the total damages for failing to collect sales tax on shipping charges could include:

Three times the taxes, penalties and interest owed for as long as 10 years

A civil penalty of between \$5,500 and \$11,000 for each fraudulent act. Each monthly sales tax return filed by the retailer that did not include sales tax on shipping charges could be considered an act.

Reasonable attorneys’ fees.

What Retailers Can Do To Protect Themselves

Despite the *Kean* ruling, the application of sales tax to shipping and handling charges remains somewhat unclear. Among other things, the *Kean* Court suggested that giving buyers the option to pick up purchases at a designated place rather than requiring them to pay for delivery would likely eliminate the application of sales tax on shipping and handling charges. In addition, the Illinois Department of Revenue is reviewing the regulation on this issue but has yet to indicate what its final position will be. Regardless of the outcome, however, retailers should verify that their current practice includes the collection of sales tax on any shipping charges in excess of the actual cost of shipping. This requirement to apply the tax to any charges over the actual shipping cost is well settled in Illinois and elsewhere around the country. There are a number of things that online retailers who ship goods into Illinois can do to try to protect themselves. First, they should review their online practices and determine whether they collect sales tax on shipping and handling charges for sales delivered in Illinois, and, if not, whether they allow in-store pickup and whether the cost to purchasers for shipping and handling exceeds the actual cost of delivery. Online retailers should contact counsel if they have any concerns about their practices. If they are sued, the retailer should engage knowledgeable counsel to ensure that all possible defenses are raised and confirm whether or not their sales practices fall outside the scope of the *Kean* decision. In addition, there are a number of technical defenses to a whistleblower suit that should be evaluated, including defenses relating to whether the plaintiff is a proper party and whether a whistleblower lawsuit is the proper action to recover sales tax.

Finally, this issue is not limited to Illinois. Most states, as well as the federal government, have whistleblower statutes similar to Illinois. These laws may support lawsuits wherever a plaintiff can

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allege that a retailer is either not collecting tax when the retailer should be or the retailer is collecting tax when the retailer should not be. Although many state whistleblower statutes exclude tax matters, others do not. Retailers are well-advised to undertake a thorough review of their policies and practices regarding the collection of sales tax on shipping and handling charges.

Contact Info

For additional information, please contact your Husch Blackwell attorney.