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COMMENTARY

Illinois Department of Revenue Close to Clarifying Rules on Taxability of Shipping and Delivery Charges

For the past several years, out-of-state retailers have been confounded by the tax treatment of shipping and delivery charges on merchandise shipped to Illinois consumers. Recently, a single law firm has filed hundreds of qui tam lawsuits pursuant to the Illinois False Claims Act targeting out-of-state wine and liquor producers and retailers based on their alleged failure to collect and remit taxes on delivery charges on shipments to Illinois customers who made purchases over the internet. While these claims almost always lack merit, the cost of fighting them is generally far greater than simply agreeing to settle, resulting in an unwarranted windfall for the purported relator in the lawsuits.

State officials are now taking steps on a number of fronts to combat this abusive behavior, including an effort to clarify the law on the taxability of delivery charges. As we previously reported in "Illinois Attorney General's Office Announces Intention to Dismiss False Claims Act Cases Against Liquor Retailers" (August 2015), the Illinois Attorney General has filed motions to dismiss a number of these cases against out-of-state liquor retailers, based on lack of nexus. In the same vein, on January 20, 2016, Cook County Circuit Court Judge Thomas Mulroy granted the State of Illinois's motion to dismiss several of these cases against wineries, finding that absent fraud, misconduct, or bad faith by the Attorney General, it is up to the state to decide which cases it wishes to pursue.

In addition to the Attorney General's action, in August 2015, the Illinois Department of Revenue ("IDOR") proposed amendments to its regulations concerning the taxation of shipping and handling charges.[1] These amendments were designed to clarify when retailers are required to collect sales and use taxes on delivery charges to Illinois consumers. The proposed language makes clear that as long as a retailer allows the customer the option to pick up the products purchased (regardless of the retailer's location and the likelihood of the purchaser exercising that pickup option), there is no "inseparable link" between the purchase price for the product and any delivery and shipping charge the customer opts to incur, making the delivery and shipping charges on that purchase nontaxable. These amendments, which apply to all transactions after November 2009, should also effectively resolve the central question present in many of the pending False Claims Act cases concerning whether an out-of-state pickup option was sufficient to render any delivery charges nontaxable.

On January 19, 2016, IDOR submitted its Second Notice of Proposed Rulemaking to the Illinois Joint Committee on Administrative Rules ("JCAR"), indicating that it will incorporate several changes to the proposed regulations as a result of comments received during the first notice period. Text of the revised amended proposed regulations was released on February 4, 2016.[2] The revised amendments to the regulations were scheduled to be discussed at JCAR's February 16, 2016 meeting, but based on comments from the relator and questions from one of JCAR's members, the second notice period has been extended for another 45 days (until April 18, 2016) and will likely be on the agenda for either the March or April JCAR meeting.

In the revised amended proposed regulations, perhaps the most significant item IDOR addressed were concerns raised during the first notice period about potentially unintended consequences of the fact that the proposed regulations would be retroactive to the date of the Illinois Supreme Court's decision in *Kean v. Wal-Mart Stores, Inc.*[3] In *Kean*, the Illinois Supreme Court first established that delivery or shipping charges were taxable where they had an "inseparable link" to the sale itself.[4]

In response to the proposed amended regulations released during the First Notice of Proposed Rulemaking, multiple commenters requested that IDOR clarify that taxpayers who either: (i) collected and remitted tax on delivery charges based on their belief that the delivery charges had an "inseparable link" to the sale under *Kean*, or (ii) did not collect and remit tax on delivery charges, based on prior guidance of IDOR that retailers who offered a pick-up option need not collect tax, would nevertheless be held to have correctly remitted tax on delivery charges during the time period between the *Kean* decision (November 19, 2009) and the effective date of the proposed regulations. The concern raised by the commenters was that the retroactive effect of the amendment could potentially give rise to yet another round of private lawsuits against taxpayers who either (i) collected and remitted tax on delivery charges, based on their belief that there was an "inseparable link" to the sale under *Kean* (potentially giving rise to Consumer Fraud Act claims that they overcollected taxes), or (ii) did not collect or remit tax on delivery charges, based on their reliance on prior IDOR guidance that no tax collection was necessary in the event the purchaser had the option to pick up the property at the seller's location (potentially giving rise to new False Claims Act cases that they undercollected taxes).

In its Second Notice of Proposed Rulemaking, IDOR indicated that it "added a safe harbor provision" to cover this situation.[5] Specifically, the proposed regulation was amended to provide that taxpayers who "computed their tax liability according to the provisions of either subsection (a) or subsection (b) of this Section for periods between November 19, 2009 and [the effective date of the amended regulations] shall be considered to have properly collected and remitted those charges."[6] In theory, this should prevent potential after-the-fact claims from the plaintiffs' bar against taxpayers regardless of whether they computed their tax liability by omitting tax on separately stated shipping charges under the prior version of the regulations, or remitted tax on separately stated shipping charges under *Kean*.

In addition to addressing the retroactivity issue, IDOR addressed three other key items in the revised version of the proposed amendments that are now pending before JCAR.

First, where a retailer offers unqualified free shipping, or qualified free shipping for eligible transactions (e.g., free shipping for purchases of $150), there is no "inseparable link" between the selling price of the merchandise and any delivery charges the customer might choose to incur (such as additional costs for expedited shipping). Those delivery charges, therefore, will remain nontaxable as long as the actual selling price does not increase or decrease based on the delivery method chosen by the purchaser.[7]

Second, in situations where delivery charges would be taxable for some items but not for others (e.g., when there is a pickup option is available for some items ordered but a delivery-only option on others, and the customer chooses to have all items delivered), retailers can itemize the delivery charges for each item ordered such that the tax need only be collected on the items with taxable delivery charges (e.g., the item without a pickup option). If, however, a lump sum charge for delivery is assessed, then the delivery charge is nontaxable only if the selling price of the goods with the nontaxable pickup option is greater than the selling price of the goods with the taxable delivery-only option.[8]

Third and finally, IDOR amended the proposed regulations to make clear that they apply equally to: (i) retailers making sales subject to the Retailers' Occupation Tax, (ii) retailers required to collect Use Tax on sales to Illinois residents because they maintain a place of business in Illinois, (iii) persons self-assessing use tax under Sections 9 and 10 of the Use Tax Act on purchases for which no tax is collected by the retailer, and (iv) persons holding winery shipper's licenses.[9]

Once enacted, these regulations will represent another positive development in combating these abusive False Claims Act cases on delivery charges and leading one step closer to the end of this disappointing chapter in Illinois tax jurisprudence.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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Endnotes

1 *See* Proposed 86 Ill. Admin. Code 130.415 and 130.410; *see also* First Notice of Proposed Rulemaking, 39 Ill. Reg. 11865 (August 28, 2015).

2 *See* JCAR 860130-11511865r02 (February 4, 2016).

3 235 Ill. 2d 351 (2009).

4 *See id.* at 374.

5 *See* Memorandum from Vicki Thomas, Executive Director, Illinois Joint Committee on Administrative Rules to Constance Beard, Director Illinois Department of Revenue, January 19, 2106 ("Thomas Memo") at 3.

6 *See* Proposed 86 Ill. Admin. Code 130.415(b)(1)(A)(ii) at JCAR 860130-11511865r02; *see also* Thomas Memo at 4 ("[A]s a result, persons who computed their liability either under the regulation existing until the effective date of the amended regulation, or as directed under the *Kean* decision, will be held to have correctly remitted tax on delivery charges.").

7 *See* Proposed 86 Ill. Admin. Code §130.415(b)(1)(D)(iv) at JCAR 860130-11511865r02.

8 *See id.* at 130.415(b)(1)(E) at JCAR 860130-11511865r02.

9 *See id.* at §130.415(b)(1)(A)(ii) at JCAR 860130-11511865r02.