

Illinois: Attorney general moves to dismiss tax case initiated by whistleblower on state's behalf



David M. Kall | Thursday, December 27, 2018

Illinois Attorney General Lisa Madigan recently [moved to dismiss](#) a tax case brought by a tax whistleblower and, in doing so, suggested that in-state actors soliciting orders in Illinois may not have triggered “substantial nexus” to tax. We have been [following developments](#) as one notorious lawyer who has been dubbed the “king of qui tam,” Stephen Diamond, filed suit under the Illinois False Claims Act (IFCA) to prosecute non-compliance with the State’s use tax.

The IFCA permits private parties to initiate false claims act cases on behalf and in the name of the State of Illinois. These cases include cases where retailers fail to remit sales or use tax to the State. Relators who successfully bring suit on behalf of the State can recover 15-25 percent of the funds recovered through the suit. [Bloomberg Tax](#) reports that Diamond has filed 900 false claims cases over the past 15 years to allege non-compliance with the Illinois sales and use tax.

“King of Qui Tam” Sues Foreign Tailors

Recently, Diamond’s law firm filed suit against dozens of foreign tailors who may be liable for Illinois sales or use tax. The tailors are based primarily in Hong Kong, the U.K., and Thailand and host “trunk shows” at Chicago area hotels to solicit custom-made clothing. The custom clothing, though, is sewn and shipped from out-of-state locations directly to the Illinois customers. The tailors do not collect or remit Illinois sales

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or use tax to the state of Illinois.

Diamond brought many suits on behalf of the state of Illinois to assert that the tailors exploited the Illinois marketplace, established a physical presence there, and ultimately triggered nexus for Illinois to tax through their “trunk shows” and thus owe use tax to Illinois on their sales transactions. Under U.S. Supreme Court decisional law precedent, he may well be right.

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But Illinois has moved to dismiss pursuant to a provision in the IFCA that allows the state’s attorney general to dismiss cases that whistleblowers initiate. According to the Illinois attorney general’s [motion](#), the cases would not recover enough tax revenue to justify the legal expenses required to successfully prosecute or monitor the litigation. The “de minimus” tax revenue at issue in each case, the attorney general argues, is not enough to justify allocating resources to the litigation.

Even further, the attorney general suggests in its motion that the tailors have *not* established “substantial nexus” to tax in Illinois despite in-state persons acting on their behalf to solicit sales orders. The Illinois attorney general cites to a [recent Illinois law](#) that adopts the economic presence standard similar to the South Dakota law that the U.S. Supreme Court blessed as constitutional in the 2018 case *South Dakota v. Wayfair*. That law does not require retailers to collect and remit tax on Illinois sales if: (a) they are located “outside of Illinois”; and (b) have less than \$100,000 in gross annual sales to Illinois residents and fewer than 200 annual in-state sales transactions. By citing the law, the attorney general suggests that the Hong Kong tailors do not establish substantial nexus for the state to exercise its taxing power over the tailors through their physical presence in the state.

While there is a statutory exception to nexus under Illinois law for retailers visiting the state for trade shows, it is not clear that the foreign tailors would meet that statutory “de minimus” exception. The Illinois law rules out nexus to tax for trade shows only where the retailer:

- a. Attends two or fewer trade shows.
- b. Spends 8 or fewer days in the state.
- c. Has \$10,000 or less in annual in-state revenue.

Arguably, the Illinois General Assembly already set the “de minimus” bar and the attorney general’s motion is trying to raise it, thereby limiting the state’s power to tax.

Did the Illinois AG “Prove Too Much”?

It will be up to the Cook County Circuit Court to hold a hearing on the Illinois attorney general’s motion and decide whether to dismiss Diamond’s lawsuit against the Hong Kong tailors. In what could be a setback to attorneys seeking large awards under qui tam laws, the Circuit Court may well dismiss under the authority vested in the Illinois attorney general under the IFCA. Whether the Illinois attorney general “proved too much” by her motion to dismiss arguing against substantial nexus to tax remains to be seen, depending on whether the issue arises in other tax cases the State is attempting to prosecute.



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