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Illinois Local Sales Tax Sourcing Update: Tax Administration by Lawsuit

Previously, we advised of actions filed by the Regional Transportation Authority (RTA), the city of Chicago and Cook County against multiple companies as “respondents in discovery.” These actions all involved the proper sourcing in Illinois of purchases made through third-party order processing and acceptance contractors for local sales tax purposes. A new lawsuit filed by the RTA in the Circuit Court of Cook County against American Airlines Group, Inc. (“American”), and the city of Sycamore, Illinois, gives an indication of the type of relief that might be sought against the respondents in discovery if they are eventually named as defendants. (The respondents in discovery must be named as defendants within six months of the date they were named as respondents in discovery.)

In *Regional Transportation Authority v. American Airlines Group, Inc.*, 2014 CH 04240, the RTA seeks a declaratory judgment that American’s fuel purchases from its subsidiary, American Supply – which is located in the city of Sycamore, 50 miles from O’Hare airport and outside the RTA taxing jurisdiction – are, in actuality, sales occurring within the RTA taxing jurisdiction, and should be sourced accordingly on a go-forward basis. In addition, the RTA asks that American pay the RTA all of the sales tax revenues that were remitted to Sycamore, rather than to the RTA, plus statutory interest. In the alternative, the RTA asks that a constructive trust be imposed for all sales tax revenues Sycamore received from American, as well as for all sales tax revenues that Sycamore rebated to American pursuant to American’s agreement with Sycamore to source sales to Sycamore in exchange for American locating its order processing operations within Sycamore. In an alternative count, the RTA asks that the court declare that American was not subject to the sales tax at all, but was instead subject to Illinois Use Tax on its purchases of fuel, and asks for the amount of Use Tax revenues the RTA would have received. The 6.25 percent Illinois Use Tax includes a 1.25 percent local tax

component, the proceeds of which are distributed to counties and municipalities on the basis of population, rather than on the situs of a purchase or sale. Thus, the RTA asks that American be made to pay Illinois Use Tax, rather than the Illinois sales tax, on the sales sourced to Sycamore.

Interestingly, the Illinois Department of Revenue (the “Department”) is not named as a defendant in the RTA’s suit, and no allegations are made about the Department. The Department’s current Emergency Rules on sourcing (described in our [January 27 alert](#)) would appear to foreclose any effort to seek declaratory relief from the Department, as the Emergency Rules are the law currently in effect, as will be the case for the Department’s already-proposed permanent rules, if and when they are adopted. Of course, such rules may result in the sourcing of all sales in a manner to the RTA’s liking, but unless they are attacked as invalid, the rules would obviate the need for the declaratory relief requested. In addition, under Illinois law, the Department is charged with the collection and distribution of local taxes. As a consequence, the RTA’s suit against American could result in double taxation, because the RTA is asking American to pay the taxes it already paid to the Department and that were sourced to Sycamore a second time. This completely ignores the Department’s statutory authority to reallocate and recover misallocated local tax revenues. Likewise, if American were to be required to pay Illinois Use Tax instead of Illinois sales tax as a result of the RTA’s suit, the amount of Use Tax that might be distributed to the RTA would not correlate to the amount of sales tax that the RTA would have received if American’s sales were sourced in the manner that the RTA is requesting, because Use Tax receipts are distributed statewide based on population.

Respondents in discovery in the other action filed by the RTA can look to this lawsuit as a possible precursor to the actions that may be brought against them as defendants. One of the two law firms representing the RTA in the current litigation against American, is also counsel for the RTA in the respondent in discovery proceedings.

One must question whether the Department will be content to allow the RTA to do an end-run in court around the Department’s statutory role as administrator of the local sales tax laws at issue, and as the administrator of the Use Tax Act; or whether the Department will seek to intervene to assert its role in making some of the determinations the court is being asked to make, and in implementing some of the relief the court is being asked to dispense. If the Department’s actions in the False Claims Act cases involving sales tax collection on shipping and handling are any indication (see our [February 4 alert](#)), the Department may not seek an active role in the RTA litigation and, as in those cases, the Department may ultimately bear the brunt of unintended consequences.

For more information on the pending Illinois local sales tax sourcing litigation, please contact one of the authors of this alert, or the Reed Smith attorney with whom you normally work. For more information on Reed Smith's Illinois tax practice, visit www.reedsmith.com/iltax.

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