2017 IL App (1st) 152829-U
No. 1-15-2829
March 28, 2017

SECOND DIVISION

IN THE

APPELLATE COURT OF ILLINOIS

FIRST DISTRICT

STATE OF ILLINOIS, *ex rel.* STEPHEN B. DIAMOND, P.C.,	)	Appeal from the Circuit Court Of Cook County.
Relator-Appellant,	)	No. 13 L 13193
v.	)	The Honorable Margaret A. Brennan, Judge Presiding.
THE WINETASTING NETWORK, d/b/a WINETASTING.COM and TSG, LLC,	)	
Defendants-Appellees.	)	

JUSTICE NEVILLE delivered the judgment of the court.
Justice Mason concurred in the judgment.
Justice Pierce dissented.

ORDER

¶ 1 *Held*: Where the plaintiff failed to identify a false statement or record the defendants made, the plaintiff failed to state a cause of action under the Illinois False Claims Act.

¶ 2 Stephen B. Diamond, P.C., filed a *qui tam* action against Winetasting.com and TSG, LLC, under the Illinois False Claims Act (IFCA) (740 ILCS 175/1 *et seq*. (West 2012)), alleging that the defendants sold wines without paying all of the requisite taxes. The circuit court dismissed the complaint with prejudice for failure to state a cause of action. We affirm

because we find that the complaint fails to specify a false statement that defendants allegedly made.

¶ 3 BACKGROUND

¶ 4 On June 14, 2013, Stephen Diamond ordered a bottle of Trinitas 2010 Moscato wine from Winetasting.com. Winetasting charged Diamond $36.95 for the transaction. On the order confirmation form, Winetasting showed that it charged $16 for the wine, $19.95 for shipping, and $1 for sales tax. Diamond ordered a bottle of Vallebelbo Moscato d'Asti Sparkling Dessert wine in July 2013, and Winetasting charged him $22.99 for the wine, $19.95 for shipping, and $1.44 for sales tax, for a total of $44.38. In August 2013 he ordered a Willunga 2011 Chardonnay, for which Winetasting charged $35.88: $14.99 for the wine, $19.95 for shipping, and $0.94 for sales tax.

¶ 5 In November 2013, Diamond filed a complaint charging Winetasting's parent company, 1-800-Flowers.com, with violating the IFCA. The State of Illinois decided not to intervene (see 740 ILCS 175/4(a)(4)(b) (West 2012)), thereby permitting Diamond, as relator, to prosecute the *qui tam* action on behalf of the State.

¶ 6 TSG, LLC, acquired Winetasting's assets in January 2014. In March 2014, Diamond ordered a bottle of Maffick Moscato 2012 Mendoza wine, for which TSG, through Winetasting, charged Diamond $34: $16.99 for the wine, $15.95 for shipping, and $1.06 for sales tax. Another bottle of the same wine, again ordered from TSG through Winetasting, cost Diamond $58. Diamond requested an especially speedy delivery, so the shipping cost was $39.95. And in October 2014, Diamond ordered from Winetasting an Arnold Palmer

2009 Cabernet Sauvignon wine, which cost $15 for the wine, $19.95 for shipping, and sales tax of $0.94, for a total of $35.89.

¶ 7 Diamond filed an amended complaint in March 2015, naming as defendants Winetasting, TSG, and several other parties subsequently dismissed from the lawsuit. Diamond alleged that Winetasting and TSG did not produce the Trinitas, Vallebelbo, Willunga, Maffick, and Arnold Palmer wines they sold to Diamond. Because they sold wines they did not produce, according to Diamond, Winetasting and TSG acted as liquor retailers, and the Retailer's Occupation Tax Act (35 ILCS 120/1 *et seq*. (West 2012)) required them to collect local taxes in addition to the state sales tax. Diamond did not attempt to identify the location to which Winetasting and TSG owed the local tax, and he admitted that the Retailer's Occupation tax varied, depending on the county and the city from which the retailer sold the wine.

¶ 8 For the claim that Winetasting and TSG violated the IFCA, Diamond alleged:

> "[Winetasting] and TSG knowingly made false records or statements to the State of Illinois when they:
>
> a) Programmed their Website to email order confirmations that falsely omit the difference between the 6.25% rate and the rates imposed under the Retailer's Occupation Tax on Website and other direct marketing sales to Illinois customers;
>
> b) Generated invoices, accounting records and other documents that falsely omit the difference between the 6.25% rate and the rates imposed under the

Retailer's Occupation Tax on Website and other direct marketing sales to Illinois customers;

c) Failed to collect and remit the difference between the 6.25% rate and the rates imposed under the Retailer's Occupation Tax on Website and other direct marketing sales to Illinois customers."

¶ 9 Winetasting and TSG filed separate motions to dismiss the complaint for failure to state a cause of action. See 735 ILCS 5/2-615 (West 2014). The circuit court granted both motions, dismissing the complaint with prejudice. Diamond now appeals.

¶ 10 ANALYSIS

¶ 11 When the circuit court dismisses a complaint for failure to state a claim for relief, "we accept as true all well-pleaded facts and all reasonable inferences that may be drawn from those facts. [Citation.] We also construe the allegations in the complaint in the light most favorable to the plaintiff. [Citation.] Thus, a cause of action should not be dismissed pursuant to section 2-615 unless it is clearly apparent that no set of facts can be proved that would entitle the plaintiff to recovery." *Marshall v. Burger King Corp.*, 222 Ill. 2d 422, 429 (2006). We review de novo the order granting the motion to dismiss. *Marshall*, 222 Ill. 2d at 429. Because the General Assembly modeled the IFCA on the Federal False Claims Act (FCA) (31 U.S.C. § 3729 *et seq.* (2000)), Illinois courts interpreting the IFCA have relied on federal courts' interpretations of the FCA. See *State ex rel. Beeler, Schad & Diamond v. Target Corp.*, 367 Ill. App. 3d 860, 865 (2006); *State ex rel. Beeler Schad & Diamond, P.C. v. Ritz Camera Centers, Inc.*, 377 Ill. App. 3d 990, 997-98 (2007). For purposes of this appeal, we

accept as true Diamond's allegation that defendants did not produce the wines he purchased online.

¶ 12 Diamond claims that his complaint states a cause of action for "reverse false claims." See *Ritz Camera Centers, Inc.*, 377 Ill. App. 3d at 998. Usually, a cause of action under the IFCA charges the defendant with filing a fraudulent claim to obtain a payment from the government. See *United States ex rel. Schmidt v. Zimmer, Inc.*, 386 F. 3d 235, 242 (3d Cir. 2004). In a cause of action for a reverse false claim, the government charges the defendant with making a false statement to reduce or avoid a payment the defendant owes to the government. *Cafasso v. General Dynamics C4 Systems, Inc.*, 637 F.3d 1047, 1056 (9th Cir. 2011). A cause of action for reverse false claims "requires proof that the defendant `knowingly' made, used, or caused to be made a false record or statement to avoid an obligation." *Ritz Camera*, 377 Ill. App. 3d at 996 (quoting *United States ex rel. Bahrani v. Conagra, Inc.*, 465 F.3d 1189, 1205-06 (10th Cir. 2006)).

¶ 13 Because the General Assembly adopted the IFCA to combat fraud (see *State ex rel. Beeler, Schad & Diamond v. Burlington Coat Factory Warehouse Corp.*, 369 Ill. App. 3d 507, 510-11 (2006)), a complaint for violation of the IFCA must meet the specificity requirements for fraud claims. *Hopper v. Solvay Pharmaceuticals, Inc.*, 588 F.3d 1318, 1324 (11th Cir. 2009). Thus, the plaintiff in an action under the IFCA must identify the time, place, and contents of the false representations, and what the defendant obtained by means of those representations. *United States ex rel. Doe v. Dow Chemical Co.*, 343 F.3d 325, 329 (5th Cir. 2003).

¶ 14 Diamond's complaint identifies email order confirmations, invoices, accounting records and "other documents" as the places where the defendants made false representations. Diamond specified the time and contents of the order confirmations and invoices by attaching several to his complaint. The email order confirmations and invoices show that in each transaction the defendants charged Diamond a tax of 6.25% of the wine's sale price, in accord with Illinois use tax. Diamond alleges that the documents "falsely omit" the Retailer's Occupation taxes.

¶ 15 The *Ritz Camera* court confronted a similar allegation. In *Ritz Camera*, Diamond alleged that Ritz Camera's invoices falsely showed a tax of $0, when Ritz Camera had an obligation to collect a use tax of 6.25%. The *Ritz Camera* court said:

> "We conclude that a document reflecting that no use tax is being collected and the document reflects that use tax due is '$0.00' cannot be considered false for purposes of the Act. We agree with defendants' position that a document that reflects the tax due relating to a transaction is $0 and that no tax was in fact being collected cannot be false for purposes of the Act but, instead, represents a truthful assertion. *** Since the documents at issue are factually true, in our view, factually true statements cannot be considered sufficiently false for purposes of bringing a claim under the Act." *Ritz Camera*, 377 Ill. App. 3d at 1002-03.

¶ 16 The emails, invoices, and accounting documents that accurately reflect the collection of the use tax on the price of the wine, and no other taxes, cannot constitute the requisite

fraudulent representations for purposes of the IFCA. Diamond's complaint includes no factual allegation of any false statement in the emails, invoices, of accounting records, and he points to no specific "other documents" that include false statements. Diamond may have adequately alleged a violation of the Liquor Control Act (see 235 ILCS 5/5-1(d) (West 2014)), but not every statutory violation involves a false representation. Because Diamond failed to plead any specific false representations, the trial court correctly dismissed the complaint for failure to state a cause of action under the IFCA.

¶ 17 The dissent asks this court to ignore the specificity pleading requirements for fraud claims. Neither the dissent nor the appellant has identified a document in which Winetasting or TSG made a false statement or omission of fact. We will not abandon the specificity requirement for fraud claims under the IFCA. Therefore, we must find that Diamond failed to state a cause of action under the IFCA.

¶ 18 CONCLUSION

¶ 19 Because Diamond failed to plead a specific false representation the defendants made, we affirm the dismissal of Diamond's complaint.

¶ 20 Affirmed.

¶ 21 Justice Pierce, dissenting.

¶ 22 The importance of effective enforcement of our sales and use tax statutes and the critical need for state and local taxing authorities to collect sales and use taxes to fund governmental services cannot be ignored given the magnitude of retail sales that take place over the internet and the amount of sales, use, and local taxes that are or should be collected by out-of-state

retailers. Here, defendant is in direct competition with local wine distributors and maintains a competitive advantage if it does not collect the same tax that local distributors are required to collect. The legislature has declared that it is the public policy of this state "to collect sufficient revenue from excise and use taxes on alcoholic beverages" and has declared that the direct sale of alcoholic liquor from outside the state to Illinois customers "poses a serious threat" "to State revenue collections; and the economy of this State." 235 ILCS 5/6-29.1(a)(3), (b). (West 2014). The majority's decision will only encourage non-compliance by foreign retailers to the disadvantage of local merchants and local taxing authorities. I respectfully dissent.

¶ 23 Collectively, the Retailer Occupation Tax Act (35 ILCS 120/1) (West 2014), the Use Tax Act (35 ILCS 105/1) (West 2014), and the Liquor Control Act (235 ILCS 5/1-1) (West 2014) embody a comprehensive scheme for the collection of sales and use taxes by retailers, regardless of whether the retailer is located in state or out of state. Here, defendant submitted to the jurisdiction of the Illinois Department of Revenue, registered to collect use taxes, consented to the enforcement of all related laws, rules, and regulations of the Liquor Control Act and the Department of Revenue, and consented to the jurisdiction of Illinois courts. 235 ILCS 5/5-1(r) (West 2014). No citation is needed to support the notion that the State has a right to file suit against a retailer it believes is not in compliance with these Acts. Plaintiff, as relator, is acting on behalf of the state in an attempt to collect taxes due on internet wine sales by the defendant. Plaintiff's claim is not novel. It is straightforward: the defendant, a licensed retailer, sold a product and knowingly did not collect all the tax due on these sales. As

evidence of the failure to collect local taxes, relator attached to the complaint records that show which taxes were collected or remitted. Those same records inferentially show the local tax was not collected. To recover this lost tax revenue, relator filed what is known as a "reverse false claim."

¶ 24 A reverse false claim alleging a tax violation on internet sales is authorized under the IFCA. *State ex rel. Beeler Schad & Diamond, P.C. v. Ritz Camera Centers, Inc.*, 377 Ill. App. 3d 990, 1008 (2007). "The Act does not seek to impose and collect a tax, but instead seeks to penalize actions that deprive the government of funds rightfully owed to it regardless of the nature of the underlying transaction giving rise to the claim." *Id.* at 1005-1006. That is the gist of the plaintiff's claim in this case. Dismissal under section 2-615 is not warranted.

¶ 25 The cause of action alleged here is essentially the same as the causes of action in *State ex rel. Beeler, Schad & Diamond, P.C. v. Relax The Back Corporation*, 2016 IL App (1st) 151580, and *State ex rel. Schad, Diamond & Shedden, P.C. v. National Business Furniture, P.C.*, 2016 IL App (1st) 150526, involving the failure of a retailer to collect a tax it was require to collect. Although the state ultimately did not prevail in those cases, the claims that went to trial are virtually identical to the claim alleged in this case. Because plaintiff has met the minimum pleading requirements to state a cause of action for a reverse false claim, the relator should be allowed to try this case to a conclusion.

¶ 26 The state has a cause of action against a retailer where the retailer correctly declares and remits the full amount of the tax collected, but that amount is less than what should have been collected because the retailer knowingly did not collect a tax it was obligated to collect.

For example, if the tax collected by the retailer was a state sales tax of $1, but the law required the retailer to also collect a city tax of $1, even though the retailer correctly reported and remitted the $1 collected, a "reverse false claim" cause of action lies. *Ritz Camera*, 377 Ill. App. 3d at 1005-1006. To prevail against the defendant retailer in a reverse false claim case, the plaintiff has to *prove* the retailer knowingly used, or caused to be made, a false record or statement to avoid payment of the entire tax due. Pleading and proof, as everyone would acknowledge, are separate considerations.

¶ 27 The majority conclusion, based on *Ritz Camera*, is clearly in error. Finding that the reverse false claim cause of action is doomed because relator's exhibits (consisting of emails, invoices, and accounting records) include no factual allegation of falsity completely misses the point. The purpose of attaching those purportedly accurate exhibits is to show a factual basis in support of the allegation that defendant collected and remitted an amount less than what the law required it to collect and remit. These records show two things: that the sale tax was collected and remitted, and the local tax was not collected and remitted. Any failure to allege specifically which local tax was not collected is not fatal at this point because defendant did not raise this issue and, in any event, which local tax was omitted can be addressed through a bill of particulars or other pre-trial procedure available under the Code of Procedure.

¶ 28 The majority conclusion that relator's exhibits "that accurately reflect the collection of the use tax on the price of the wine, and no other taxes, cannot constitute the requisite fraudulent representations for the purposes of IFCA" (*supra* ¶¶ 14, 16), based on the decision

in *Ritz Camera*, misconstrues the discussion in *Ritz Camera* regarding accurate documents. There, we were asked to answer several certified questions. The first certified question asked: "As a matter of law, if a remote retailer does not collect and remit use tax on sales to Illinois customers, can it make a 'knowingly' false record or statement, as required to create liability under the Illinois Whistleblower Reward and Protection Act, 740 ILCS 175/1?" *Ritz Camera*, at 993. We found that "under the circumstances of this case" where the law is unclear and a specific factual analysis is required to determine whether a retailer knowingly made a false record, "a remote retailer cannot make a 'knowingly' false record or statement under the" IFCA. *Id*. at 997. In affirming the denial of a section 2-615 motion to dismiss on the grounds that the defendant's records accurately showed the tax collected, we answered the first certified question stating that "[A]s such, the trial court did not err in denying the motion to dismiss in light of the necessary factual determinations that must be made regarding defendants' 'knowledge'." *Id*. at 999.

¶ 29 Here, the majority's reliance on a quote from *Ritz Camera* (*supra* ¶ 15) is incomplete and is taken out of context. After addressing the first certified question described above, we then found that the Whistleblower Act "requires the existence of an actual record or statement" to support a claim under the Act, but "the failure to keep a record when required to do so may be actionable under the Act given the proper factual scenario." *Id.* at 999. We then turned to a related certified question, which asked, "As a matter of law, can documents memorializing a purchase *** that show in the line item for the tax '$0.0' or in some other way that the tax is

not being collected be considered 'false' under the Whistleblower Act where the retailer that created those documents does not collect tax?" We answered:

> "We conclude that a document reflecting that no use tax is being collected and the document reflects that use tax due is "$0.00" cannot be considered false for purposes of the Act. We agree with defendants' position that a document that reflects the tax due relating to a transaction is $0 and that no tax was in fact being collected cannot be false for purposes of the Act but, instead, represents a truthful assertion. *We must emphasize that our inquiry here is not to determine whether a knowingly false statement is required, which is the subject of the first certified question but, instead, whether a statement that is factually true can be deemed false for purposes of bringing a claim under the Act.* Neither party here disputes that no use tax was collected or that the invoices rendered to the purchasers reflected that no use tax was collected or due. Since the documents at issue are factually true, in our view, factually true statements cannot be considered sufficiently false for purposes of bringing a claim under the Act. See *Fru-Con Construction Corp.*, slip op. at 17, citing *Hindo v. University of Health Sciences/The Chicago Medical School*, 65 F.3d 608, 613 (7th Cir.1995)." (Emphasis added.) *Ritz Camera*, 377 Ill. App. 3d at 1002-03.

¶ 30 Thus, a complete reading of *Ritz Camera* shows that, at the very least, when considering a section 2-615 motion to dismiss a reverse false claim pleading, a complaint alleging the failure to collect and remit *all* applicable tax due on wine shipped by defendant is sufficient

where the exhibits show that *a* tax was collected and remitted, and the same records show that the defendant did not collect *other* taxes that it was required to collect and remit. "Rather, *** in order to recover under [the false claim act], the plaintiff must also prove that the false information, be it in the form of an affirmative statement *or an omission*, was knowingly submitted by the defendant to the United States Government for the purpose of avoiding a debt or obligation to the government." *Id.* at 997 (citing *Wilkins ex rel. United States v. State of Ohio*, 885 F. Supp. 1055, 1059-60 (S.D. Ohio 1995)).

¶ 31 *State ex rel. Beeler, Schad & Diamond, P.C. v. Relax The Back Corporation*, 2016 IL App (1st) 151580, was a IFCA case where the relator claimed that the out of state retailer failed to collect and remit use tax on internet and catalog sales to Illinois customers. *Id*. ¶ 1. After a bench trial, the circuit court found no liability on the failure to collect the use tax on internet sales because the defendant made an honest effort to determine whether it was obligated to Illinois as a result of its internet operations. *Id*. ¶ 13. However, the circuit court found liability on defendant's catalog sales (*id*. ¶ 14) because, unlike internet sales, defendant did not undertake a sufficient investigation to determine whether it was liable to collect and remit on its catalog sales (*id*. ¶ 15).

¶ 32 The *Relax The Back* court, relying on *Ritz Camera*, reversed the finding of liability as to the catalog sales, recognizing that more than a failure to record or report an obligation to pay is required to find a violation of the IFCA. Rather " 'in order to recover *** the plaintiff must also prove that the false information, be it in the form of an affirmative statement *or an omission*, was knowingly submitted by the defendant to the [government]for the purpose of

avoiding a debt or obligation to the government.' " (Emphasis added.) *Relax The Back*, 2016 IL App (1st) 151580, ¶ 19 (citing *Ritz Camera*, 377 Ill. App. 3d at 998 (quoting *Wilkins*, 855 F.Supp. at 1064)). We went on to state that section 3(b)(1)(A) of the IFCA defines "knowledge" and "knowingly" as having actual knowledge of the information, acting in deliberate ignorance of the truth or falsity of that information or acting recklessly in disregard of the truth or falsity of the information. (*Id*., ¶ 26). 740 ILCS 175/3(b)(1)(A)(i)-(iii) (West 2014). Thus, an affirmative omission, or an act in reckless disregard of the truth or falsity of the information available, is actionable. *Id*., ¶ 30. *Ritz Camera Centers, Inc.*, 377 Ill. App. 3d at 998; 740 ILCS 175/3(b)(1)(A)(i)-(iii) (West 2014).

¶ 33 The majority's conclusion that plaintiff "may have adequately alleged a violation of the Liquor Control Act but not every statutory violation involves a false representation" (*supra*, ¶ 16) misses the point, which is that defendant violated the Liquor Control Act by not collecting and remitting more than the state sales tax, and this failure is factually supported with the attached exhibits, which show the sales tax was collected and remitted, while also tending to show that the required local taxes were not collected or remitted. In my opinion, relator would have sufficiently stated a reverse false claim cause of action without the exhibits had it merely stated that the defendant had a duty to collect a local tax and failed to do so. Thus, the majority's focus on the "accuracy" of the exhibits is a distraction that shifted the analysis away from what is the essence of a reverse false claim. As such, relator has sufficiently stated a reverse false claim case under IFCA. Plaintiff should be allowed to prove that defendant had an obligation to collect and remit local taxes on wine that it did not

produce (similar to the *Relax The Back* and the *National Business Furniture* litigation), defendant knew it was required to do so, and defendant either made an affirmative omission, or acted in reckless disregard of the information available to it as a licensed wine seller, that it was required to collect and remit a local tax. Here, the result after trial may be the same as in *Relax The Back* and *National Business Furniture*, but that is not our concern at the pleading stage. I would reverse the order of the circuit court and remand for further proceedings.