A Conservative Approach in Collecting Taxes Is Not Fraud

by Stanley R. Kaminski, John D. Kendzior, and Kyle T. Molidor

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For years the Illinois Consumer Fraud and Deceptive Business Practices Act (Consumer Fraud Act) has been used to challenge businesses that were alleged to have overcollected Illinois sales taxes. Many of these lawsuits swept in businesses that were simply trying to comply with Illinois tax laws in a reasonable but conservative manner to avoid possible tax assessments for underpaying sales taxes. In the recent case of Bartolotta v. Dunkin’ Brands Group Inc., the U.S. District Court for the Northern District of Illinois dismissed with prejudice a class action suit against Dunkin’ Brands Group Inc. and one of its franchisees in Illinois (collectively referred to hereinafter as Dunkin’), which alleged that Dunkin’ violated the Consumer Fraud Act by overcollecting the state’s retailers’ occupation tax (ROT) — or sales tax — on its coffee bag sales. In reaching its decision, the federal court concluded that simply taking a conservative approach in collecting taxes is not a violation of the Illinois Consumer Fraud Act.

I. Consumer Fraud Act

The Consumer Fraud Act provides protections against fraud, deceptive business practices, and other white-collar crimes, and it allows private individuals to bring suit against businesses they believe have perpetrated these acts. R. Rudnick & Co. v. G.F. Protection Inc. enumerates what a party must ultimately show to prevail under the Consumer Fraud Act: “(1) an unfair or deceptive act or practice by defendant, (2) defendant’s intent that plaintiff rely on or be treated unfairly by the act or practice, and (3) that deception occurred in the course of conduct involving trade and commerce.”

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In this article, the authors discuss the Illinois case Bartolotta v. Dunkin’ Brands Group. In the case, a U.S. district court dismissed with prejudice a class action suit alleging a violation of the state’s Consumer Fraud and Deceptive Business Practices Act when a franchisee was alleged to have overcollected the state’s retailers’ occupation tax. The authors discuss the finer points of the court’s decision.

1 See generally Kean v. Wal-Mart Stores, 235 Ill. 2d 351 (2009).
II. The Illinois Sales Tax

The ROT is imposed on retailers based on "gross receipts from sales of tangible personal property made in the course of business."\(^4\) The ROT, together with the corresponding Use Tax Act,\(^5\) provides that the rate of tax applied to food sales is 6.25 percent (the high tax rate) except when the sale is for food not prepared for immediate consumption and sold for consumption off the premises, in which case the tax imposed is 1 percent (the low tax rate). Local ROTs could also apply to those sales. The state and local ROT, as well as corresponding use tax, is collected by the seller from its purchasers to reimburse the seller for the ROT paid or the use tax due.

III. Background

In April 2016 the plaintiff, Michael Bartolotta, a Dunkin’ consumer, purchased a bag of coffee beans at the franchisee’s store and was charged the high tax rate on the sale. Bartolotta alleged that Dunkin’ was not properly collecting the ROT because it collected the high tax rate on its coffee bag sale to him, which he claimed should have been taxed at the low tax rate.

Bartolotta’s claim was based on the language of the ROT that provides that food and beverages are taxed at (i) the high tax rate if the food or beverage is prepared for immediate consumption or sold for consumption on the premises of the selling establishment, or (ii) the low tax rate if the high tax rate does not apply. Dunkin’ argued that its practice of collecting the high tax rate on its sale of coffee bags was consistent with, or at least reasonable, under the Illinois Department of Revenue food regulations to determine when to collect the high tax rate versus the low tax rate on the sale of food and beverages.

The franchisee in the lawsuit was a retail coffee/doughnut shop that sold food and beverages both for consumption on its premises and to take home. It did not have an area for consumption on premises that was physically separate or otherwise distinguishable from where food not for immediate consumption was sold. All sales by the franchisee, including all food sales, were handled by a single cash register located directly in front of the establishment’s dining area. That register did not make any distinction between sales of different food items. Rather, the franchisee’s register treated all food sales, including bags of coffee, the same for ROT purposes. Under the DOR’s food regulations, if a food establishment does not have a separate area for food sold for consumption off its premises from the area where it sells food that is sold for consumption on its premises, the establishment must treat its sales of that food as subject to the high tax rate. Thus, the franchisee believed it was simply following the food regulations when it collected the high tax rate on its sale of coffee bags.\(^6\)

IV. The Arguments

Bartolotta’s Consumer Fraud Act argument centered on his allegation that the franchisee’s practice of charging the high tax rate on the sale of coffee bags was incorrect and thus was a deceptive and unfair trade practice. The franchisee argued that it did not overcharge Bartolotta for the ROT and that even if it did, its mistake was “an honest one that cannot form the basis of an unfair or deceptive trade practices claim” because it was following the DOR’s food regulations. The franchisee further argued\(^7\) that any good-faith dispute over what rate of tax to charge only created a reasonable difference of opinion about how the ROT should be applied, which is insufficient to support a claim under the Consumer Fraud Act.\(^8\)

\(^4\)35 ILCS 120/2-10.
\(^5\)35 ILCS 105/3-10.
\(^6\)See Bartolotta, No. 16 CV 4137, at *13.
\(^7\)Id. at *12-13.
The franchisee emphasized that it followed the plain wording of the food regulations in its payment of the ROT on its gross receipts from its sales of coffee bags, including a flow chart created by the DOR as part of its regulations to easily determine how and when to apply the high tax rate or the low tax rate. The franchisee stressed that those food regulations have the "force and effect of law," so the failure to follow those food regulations could result in franchisee being liable for back taxes, interest, penalties, fines, and even incarceration.

Bartolotta countered that if the food regulations required that coffee bags be taxed at the high tax rate, they were inconsistent with the sales tax laws and should not be followed.

Under the food regulations, a food retailer that has facilities for the consumption of food on its premises, like the franchisee, is "presumed" to have prepared the food for immediate consumption or for consumption on the premises and is therefore required to pay the sales tax at the high tax rate. A retailer has the option of challenging that high-tax-rate presumption for some food sales. However, to overcome that presumption, the retailer must clearly show that:

1. The area for on-premises consumption is physically separated or otherwise distinguishable from the area where the food not for immediate consumption is sold; and
2. The retailer has a separate means of recording and accounting for collection of receipts for sales of both high [(food prepared for immediate consumption)] and low rate [(food that is not prepared for immediate consumption)] foods.

The franchisee asserted that it followed the food regulations exactly as written and charged the high tax rate on all its food sales. The franchisee said it did not challenge the high-tax-rate presumption for any of its food sales because doing so would be futile since it did not meet the requirements of subsection 130.310(d)(1) of the food regulations by segregating its sales of food items that are deemed not prepared for immediate consumption from the area it sells food items that are prepared for immediate consumption. Thus, the franchisee argued that the food regulations required the franchisee to treat all food sales, including boxes of doughnuts or bags of coffee, as taxable under the high tax rate.

Bartolotta not only questioned the correctness of the food regulations but also suggested that a couple of the examples provided in the regulations supported application of the low tax rate to coffee bag sales. One of those examples specifically states that "provided that the requirements of either subsection (d)(1) or (d)(2) are met, coffee, latte, cappuccino and tea . . . and food sold for consumption on the premises (e.g., pastries, cookies, snacks) are subject to the high rate of tax. Bulk coffees (beans or grounds, for instance), and teas, or pastries that are not consumed on the premises, are subject to the low rate of tax." The franchisee disputed that those examples supported Bartolotta’s argument, countering that he was simply misreading the examples. The franchisee pointed out that when read in context and consistently with the rest of the food regulations, those examples apply only when the seller first meets the requirement that it has a clearly segregated area from which it sells food for on-premises consumption from its sales of food for off-premises consumption.

V. Court Decision

After reviewing the briefs, examining the facts and law at issue, and hearing oral argument, the court granted Dunkin’s motion to dismiss with prejudice. The court found that neither Dunkin’ Brands Group nor the franchisee could be liable for fraud or an unfair business practice when the franchisee was
simply following the food regulations. The court explained that while both parties “have presented reasonable arguments in support of their conflicting interpretations of the applicable regulation . . . the Court [held] . . . that the better of the arguments is for the high tax rate to be applied.” Therefore, even though the court acknowledged that the regulatory language may be confusing, it agreed with the franchisee that the food regulations suggest that the high tax rate applies to the franchisee’s coffee bag sales.\footnote{\textit{Bartolotta}, No. 16 CV 4137, at *13.}

In concluding that the food regulations require the collection of the high rate of tax on coffee bag sales by the franchisee, the court also relied on a private tax letter issued by the DOR concerning the sale of gift baskets. The gift baskets included coffee bags, and the parties requesting the letter ruling asked what tax rate should apply to the bags of coffee beans. The letter ruling stated, “Assuming that over 50 percent of your food sales are not food prepared by you for immediate consumption, and that you have no on-premises dining facilities, we believe the prepackaged coffee . . . [is] taxable at the low rate of tax (1 percent plus any applicable local taxes).”\footnote{Private letter ruling ST 12-0063-GIL (Dec. 21, 2012), available at http://bit.ly/2q126Su.} The court found that a reasonable reading of this letter shows that if there are on-premises dining facilities (as was the case with the franchisee), the high tax rate applies to sales of prepackaged coffee bags.\footnote{\textit{Id.}}

As to whether the food regulations were correct, the court held it did not have to decide that issue, since the matter before the court was whether the plaintiff “adequately alleged a legally sufficient claim for a deceptive or unfair trade practice.”\footnote{\textit{Id.} at *18.} Consequently, the court stated that no such violation occurred, since the franchisee’s actions were neither deceptive nor unfair.\footnote{\textit{Id.} at *17.} Rather, what the franchisee “did here was follow a conservative interpretation of the statute and regulations, and charge the higher tax amount. It is altogether logical that they would do this.”\footnote{\textit{Id.} at *22.} Moreover, as to whether the franchisee was justified in following the food regulations, the court dismissed that argument, noting that the food regulations carry “the force and effect of law” and that the franchisee “must assume that the regulation is the law.”\footnote{\textit{Id.} at *23.}

Further, the court found that Bartolotta’s argument failed even when framed as raising a question of law about the proper application of the Illinois ROT to coffee bag sales. As to this interpretation issue, the court cited the Illinois Supreme Court for the proposition that “reasonable differences of opinion on the interpretation of a statute” are not actionable under the Consumer Fraud Act.\footnote{See \textit{Cahnman}, 701 N.E.2d 512. \textit{See also Lee}, 174 Ill. 2d 540.} Similarly, an “honest mistake concerning the interpretation of a statute that had yet to be construed” cannot support a claim under the Consumer Fraud Act, even if such interpretation is found to be in error.\footnote{\textit{Id.} at *24.} Therefore, because the franchisee’s position was based on an “altogether reasonable interpretation of the statute and implementing regulations,” its actions did not violate the Illinois Consumer Fraud Act.

The court summed up its analysis by stating, “It simply is not fraud or an unfair business practice for the [franchisee] to follow this conservative practice, even if the [franchisee]’s interpretation of the regulation is incorrect and the lower 1 percent tax could have been imposed.”\footnote{\textit{Id.} at *24.}

**VI. Conclusion**

The \textit{Bartolotta} decision is significant for businesses in Illinois since it clarifies that taking a conservative approach in paying and collecting one’s taxes is not a violation of the Consumer Fraud Act, even if it is ultimately

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\footnote{\textit{Bartolotta}, No. 16 CV 4137, at *9.}
determined to be wrong. Therefore, the simple fact that a tax may have been overcollected by a business is not enough to support a Consumer Fraud Act claim. On the other hand, while Bartolotta does provide needed clarity to businesses about the scope of the Consumer Fraud Act when it comes to business decisions made on how to properly collect Illinois taxes, it does not go so far as to give a green light to businesses to simply ignore rules or regulations that clearly direct the tax’s application. Rather, Bartolotta instructs that a business can confidently take a conservative approach to collecting and paying taxes that are due and not worry about a Consumer Fraud Act violation so long as the approach is reasonable.\(^{25}\)