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Sales tax deals in California, involving some Illinois-based consultants, under legal scrutiny

MTS Consulting LLC, Inspired Development LLC, accused in lawsuits of helping client firms route Chicago-area sales through sham offices in Kankakee and Channahon to cut tax costs, face similar claims regarding operations in Fillmore, Calif.

By Kathy Bergen and Corilyn Shropshire, Tribune reporters

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Some of the Illinois-based consultants whose sales tax reduction strategies are under legal siege here have been embroiled in a similar battle in California for more than three years, with one dispute leading to a new law and continuing to play out in the courts.

MTS Consulting LLC and Inspired Development LLC, accused in lawsuits here of helping client companies route Chicago-area sales through sham offices in Kankakee and Channahon to cut tax costs, face similar claims regarding operations in Fillmore, Calif., a small town about 50 miles northwest of Los Angeles, court documents show.

The consultants and other defendants in the lawsuits dispute that characterization, asserting that their actions have been completely within the law and that Illinois and California lawsuits are baseless.

The deals inked by those consultants and Fillmore so enraged the League of California Cities, an organization normally averse to state intervention in local affairs, that it helped draft what ultimately became a new law aimed at halting such pacts.

"There was no way we could ignore what seemed to be a fundamental inequity," said Dan Carrigg, the league's legislative director.

The local lawsuits against MTS and Inspired were brought by the Regional Transportation Authority and the city of Chicago.

Another defendant in the RTA suit, Chicago tax expert James Kane, was a consultant on a separate sales tax deal struck between the city of Modesto, Calif., and fuel distributor General Petroleum, which agreed to centralize its sales operation there in exchange for a sales tax rebate, city officials said. The pact, which won city approval ahead of the new state law, has spurred criticism that it diverts sales tax from neighboring towns, but there has been no legal challenge.

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The involvement of the Illinois consultants in controversial tax-reduction pacts in both states points to a commonality that goes beyond the national attention spawned by the states' respective fiscal crises. Both states have laws that open the door to such practices, and both have tried to curtail them. Further efforts in Illinois are expected to continue in the fall legislative veto session, with a focus on a better definition of where sales occur.

Unlike most states, Illinois and California apply sales tax where a sale occurs, rather than where a product is delivered to the customer. This can open the door to debates as to where sales actually occur and which town rightly deserves to collect the taxes.

As well, both states share a portion of their sales taxes with municipalities and give those cities a free hand in how those revenues are used. That allows cities to rebate a portion to retailers and other companies as a way to lure them to open facilities within their borders.

"The combination makes these two places good locales" for sales tax consultants to operate, said attorney Steven Blonder, counsel for MTS, which sees its tax-sharing pact with Fillmore as a legal and legitimate economic development tool for the city.

Consulting firms have approached cities such as Fillmore and Kankakee and Channahon and offered to recruit companies that will set up offices to process sales, often from their internal purchasing programs or from Internet sales. In return, the cities agree to share a portion of the new sales tax receipts with the consultants, who then split their share with their client firms.

But cities such as Livermore and Industry in California, which saw their sales tax revenue take unexpected dives, allege the remote sales offices are phony fronts, set up only as a way for companies to cut tax costs.

The two towns, which are the sites of major warehouses for medical-supply distributor Owens & Minor, noticed drops in their sales tax receipts after that company worked with MTS to open a sales office in Fillmore in late 2007. Each city estimates losing about \$2 million annually due to the company's action.

The city of Industry "is still providing police, fire, roads, infrastructure. ... We're bearing the burden but absent the sales tax," said Mark Mulkerin, the attorney representing the city in the lawsuit it filed with Livermore in 2009 against Fillmore, Owens & Minor, MTS and Inspired Development, an Illinois consultant that had a separate tax-sharing agreement with Fillmore.

The cities also asked California's board of equalization, which administers sales tax, to reallocate sales taxes back to their cities, a request that is pending. Disbursement of related tax receipts is on hold.

Owens & Minor declined to comment, noting proceedings before the state board are confidential.

Donald Sloan, president and CEO of Inspired Development, said his firm should not have been included in the lawsuit because it has no involvement with MTS or Owens & Minor. As well, it has had only one client operate an office from Fillmore, and that has been shut down, he said.

"We have nothing to do with the city of Livermore or the city of Industry," he said.

Representatives of Fillmore and Skokie-based MTS, which is headed by David Porush, an attorney who formerly worked as a tax specialist, say their agreement is perfectly legal.

"There was legislation passed in California to make these types of agreements illegal, but that was strictly prospective," said Ted Schneider, attorney for Fillmore, which is located in a citrus-growing region and is home to about 15,000 people. "Any contract before the (2009) effective date remains valid."

The lawsuit by Livermore and Industry alleges other major companies benefited from tax-sharing arrangements in Fillmore, including Walgreen National Corp., a unit of Deerfield-based Walgreen Co. and Southwest Jet Fuel.

A Walgreen Co. spokesman on Friday confirmed the company has had an office in Fillmore since 2008 but said he did not have details about the program. Southwest Airlines did not respond to requests for comment about its subsidiary.

MTS and Inspired have declined to identify clients in Illinois or California, citing confidentiality clauses in their contracts with clients. This has been a point of frustration for the RTA and city of Chicago as they try to assess what has happened with tax revenues.

But it has been a selling point for MTS as it trolled for client firms in California.

"Using MTS as the payment agent eliminates the need for public hearings and the creation of public documents that identify the participating retailers," some MTS marketing materials state. "The program provides a shield for the retail clients from any potential unwanted publicity."

The new California law prohibits a local government from using sales tax incentives to attract a retailer or consulting firm if the agreement would result in reduced revenue in another town where the retailer retains a physical presence. Illinois has had a similar law in place since 2004, but the RTA and others would like to strengthen it this fall, giving the Department of Revenue further guidance on how to determine where sales actually take place.

In California, Modesto's tax-sharing deals with General Petroleum and two other fuel distributors were struck at a time when the possibility of a law prohibiting such deals was on the horizon, local observers said.

The move rankled the Stanislaus Taxpayers Association, which viewed the deals as a tax grab from neighboring towns.

"I don't think it makes for good relationships," said Dave Thomas, president of the group whose members live in Stanislaus County, which includes Modesto as its county seat.

Tax consultant Kane, who is managing director of True Partners Consulting in Chicago, declined to comment on the specifics of the deal, referring questions to General Petroleum, which did not respond to requests for comment.

But speaking generally, Kane said it is normal for firms seeking to centralize or expand operations to seek tax incentives from prospective cities.

And Brent Sinclair, Modesto's director of community and economic development, sees the pacts with the fuel distributors as typical of the cutthroat competition that exists between cities for sales tax revenue.

"Any time a firm comes to a region, it diverts money from somewhere else, there's nothing new in that,"

he said. "Everyone is doing it to each other."

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