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Tax Policy

A number of state False Claims Acts allow individuals to pursue ''qui tam'' whistleblower suits against delinquent taxpayers. In this article, Getnick & Getnick LLP's Neil Getnick and Greg Krakower discuss these actions and argue that False Claims Act proceedings augment and expand resources to expose and prosecute more tax violations, refuting claims by others that such actions are expensive, burdensome and wholly unnecessary.

Viewpoint: Extending False Claims Acts to Tax Is a Good Idea

By Neil V. Getnick and Gregory M. Krakower

It has long been said that states are the laboratories of democracies, and that a good idea in one state can and should spread throughout the country. In the too-often static area of tax enforcement, New York's experience with its unique tax whistleblower statute has proven its worth. Other states, concerned about the ''tax gap'' created by large-scale tax frauds, and the unfairness of honest taxpayers and businesses having to make up the difference because of tax cheats, need to take notice.

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In 2010 New York State amended the New York False Claims Act (''NYFCA'') to protect, reward and empower whistleblowers that file so-called ''qui tam'' law suits exposing large state tax frauds. This revolutionary tax policy has in seven years led to tens of millions of dollars being paid to the state and whistleblowers for a variety of tax schemes. Most recently, a whistleblower-initiated case represented by Getnick & Getnick LLP and Labaton Sucharow LLP against Alabama-based Harbert Management settled with New York Attorney General Eric Schneiderman for $40 million over allegations that it avoided paying millions of dollars in taxes to New York between 2002 and 2009. The whistle-blower earned 22 percent of the reward, $8.8 million. The NYFCA has also been used to expose million dollar schemes by businesses hiding income; a medical imaging company shirking business franchise taxes; and out of state businesses that gave themselves a competitive advantage against New York businesses by illegally failing to collect sales taxes.

Tax Frauds Exposed

In each one of these cases - and others – tax frauds were exposed only because the NYFCA empowers tax whistleblowers to file suit on behalf of the government and rewards them with a portion of the recoveries. Today New York has more revenue for schools, fire departments and, hospitals because of the money recovered by tax whistleblower suits under the NYFCA and the ending of the fraudulent practices at issue.

In an article on April 26, 2017, titled, ''False Claims Acts to Tax Matters Is a Bad Idea,'' the authors suggested that tax qui tams should not be allowed because they are ''expensive, burdensome, and wholly unnecessary.'' But the above evidence demonstrates that they are a necessary and important tool in effective tax enforcement. Further, the NYFCA is a targeted law: it only applies to large scale tax frauds by large businesses and wealthy individuals. By limiting tax-based NYFCA suits to businesses that have a net income of over $1 million and where damages exceed $350,000, the New York statute is a model for other states to emulate. It has avoided two problems associated with, for example, the tax qui tam provisions of the Illinois False Claims Act. The Act is too *narrow* in that it only allows sales tax (but not income tax) qui tams, and too *broad* because it does not limit tax qui tams to large cases against large taxpayers. The fact that courts have dismissed only a handful of NYFCA tax whistleblower cases since the passage of the 2010 tax amendments demonstrates that the NYFCA is neither burdensome nor subject to widespread abuses.

Critical Facts

The April 26, 2017 article left out some critical facts to make its case against the NYFCA's tax qui tam provisions. First, it suggests that tax qui tams managed by the Attorney General are an improper means or enforcement and/or duplicative of efforts of state revenue departments. It describes the New York State's False Claims Act as an ''enforcement structure that exists alongside the normal tax structure.''

However, there is nothing duplicative about the Attorney General being involved in tax enforcement. For decades the Attorney General has been authorized by section 63(12) of the Executive Law to file civil actions against corporations for underpaying taxes. Similarly, the New York State Department of Taxation and Finance (''DTF'') has had long-standing authority to empower the Attorney General to file court actions to collect taxes, tax interest and penalties. *See* N.Y. Tax Law §1141(a) (2017).

Augment, Expand Resources

Critically, the DTF was an active supporter of allowing whistleblower-initiated tax actions under the NYFCA precisely because such actions augment and expand the DTF's resources to expose and prosecute more tax violations. And while the article states that the Attorney General's Office has been ''willing'' to consult with the DTF ''in particular cases'' - it leaves out the fact that section 189(4)(b) of the NYFCA *requires* such consultation before the Attorney General can file, or intervene in, any tax based NYFCA action. In fact, most of the tax successes under the NYFCA have been the result of partnerships and teamwork between whistleblowers, their counsel, the Attorney General, and the DTF.

Common Sense

The article also misreads the landmark New York State Court of Appeals in *People ex rel. Schneiderman v. Sprint Nextel Corp.*, 26 N.Y.3d 98 (2015) as concluding ''that a taxpayer's position is objectively reasonable is no defense against False Claims Act liability if it turns out that the Tax Department and the courts disagree with that position, even though the position was adopted in a good faith belief that it was correct.'' This is not what the decision said. In the *Sprint* litigation, the Attorney General alleged that Sprint did not, at the time of its violation, have a belief (good faith or otherwise) that its sales tax practices were legal pursuant to New York sales tax law. Accordingly, the court held that, ''[e]ven assuming there could be such a reasonable interpretation in the face of this unambiguous [sales tax] statute, it cannot shield a defendant from liability if . . . the defendant did not in fact act on that interpretation.'' *Id.* at 112. The court explicitly said that Sprint would have an opportunity at trial to show that it ''actually held such reasonable belief and actually acted upon it.'' *Id.* Far from being a harbinger of abuse this rule is actually common sense: a corporation's assertion that it could have had a good faith and reasonable belief of its tax position can only help shield it from NYFCA liability if it actually held such a reasonable belief at the time it violated the tax law.

Protected, Rewarded, Empowered

Finally, the article questions the relevance to the NYFCA of tax audits and voluntary disclosure programs. It is important to recognize that whistleblowers need to be protected, rewarded and empowered in tax matters precisely because they can expose that a company provided tax auditors with false, misleading or incomplete information. Tax audits are not necessarily designed to ferret out many of the complicated tax schemes that accountants, CFOs, or others are well positioned to report - and receive awards – as NYFCA tax whistleblowers.

The NYFCA is not a tax enforcement statute; it is a fraud statute. Tax audits and voluntary disclosures that alert the government of tax mistakes – or even tax negligence – cannot result in NYFCA liability. *See* NYFCA §188(3) (''acts occurring by mistake or as a result of mere negligence are not covered by this article). Further, as an encouragement of voluntary disclosures, the NYFCA itself lowers liability by one-third and eliminates all NYFCA civil penalties if a defendant makes a voluntary disclosure of any NYFCA violation within a month of internally discovering a tax fraud. *Id.* §189(2).

In conclusion, the results speak for themselves: the tax provisions of the NYFCA have recovered tens of millions of dollars of lost tax revenue, generated millions of dollars in whistleblower awards, given rise to a massive sales tax fraud case, and ended long-standing illegal tax practices by large corporations. The recent $40 million settlement against a hedge fund for illegal state tax allocations is a wake-up call that complicated illegal *state* tax schemes can be brought down by protected, rewarded, and empowered whistleblowers. The only bad idea in relation to a False Claims Act's application to large scale tax frauds is a decision by any state not to follow New York's example.

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