Getnick & Getnick LLP
Counsellors at Law
521 Fifth Avenue
33rd Floor
New York, NY 10175
--
(212) 376-5666 (Telephone)
(212) 292-3942 (Telefax)
e-mail: info@getnicklaw.com
www.getnicklaw.com

Tax Qui Tams

A Hot New Area Of Whistleblower Enforcement

By Neil V. Getnick, Esq.

Introduction

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, and made tax *qui tams* a new and exciting area of enforcement. Indeed, 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, are beginning to take notice.

The New York False Claims Act

Under the New York False Claims Act ("NYFCA"), any person can sue a corporation or individual that defrauds New York state or a New York local government by means of false claims, records or statements, or through the improper avoidance of an obligation to pay money to the government. *See* N.Y. State Fin. L. §§ 189, 190 (2020).

An NYFCA lawsuit is filed on behalf of the government and is known as a "qui tam" action. The government is represented by the New York State Attorney General, who can intervene and take over a qui tam lawsuit, or decline to do so, in which case the private party suing on the government's behalf, who is formally called a "relator" or a "qui tam plaintiff," can continue the litigation. If the government takes over the litigation, the relator is entitled to 15-25% of the proceeds; if the government declines to do so the relator is entitled to 25-30% of the proceeds. *Id.* § 190. The statute of limitations is ten years. *Id.* § 192.

Commonly, qui tam lawsuits are called “whistleblower” lawsuits because they are most often filed by people or entities with inside knowledge about a corporation that is defrauding the government.

<u>Tax Qui Tams Under the New York False Claims Act</u>

In 2010 New York amended the NYFCA to allow tax qui tams against businesses that have a net income or sales of over $1 million and where damages exceed $350,000. *Id.* § 189(4)(i),(ii). This was both novel and controversial. Almost every state False Claims Act, like the United States False Claims Act, includes a so-called “tax bar” that prohibits qui tam suits in connection with tax frauds. To this day, among approximately 30 states have passed False Claims Acts, *only* the NYFCA expressly allows tax qui tams.[1]

The section of the NYFCA that most commonly applies to tax frauds makes it an offense to “knowingly make[], use[], or cause[] to be made or used, a false record or statement material” to an obligation pay money to the government. *Id.* § 189(1)(g). “Knowingly,” in turn, includes acts undertaken in “deliberate ignorance” or in “reckless disregard” of the truth. *Id.* § 188(3).

“Material" is defined as having a natural tendency to influence, or be capable of influencing the payment or receipt of money or property. *Id.* § 188(5).

Ten years later we have results from New York’s experiment. Tax qui tams have resulted in over $440 million dollars being recovered by New York state and its local governments. The NYFCA has been used to expose, among other tax schemes: multi-million dollar frauds by businesses hiding New York income; businesses that gave themselves a competitive advantage

[1] The tax bars of the Rhode Island, Indiana, and Illinois False Claims Acts only apply to income taxes, and the Delaware and Nevada versions of the False Claims Act do not have any tax bar at all. *See* 72 Del. Laws 370 (Lexis 2000); 1999 Nev. Ch. 156 (Lexis 1999); 740 ILCS 175/1 et seq. (1991); 2005 Ind. PL 222 (Lexis 2005); R.I. Pub. Laws 73 (Lexis 2007).

by failing to collect sales taxes; high-end art sales structured to avoid millions of dollars of use taxes; and accounting and receipt scams.

Just in the past two years, three groundbreaking, high-profile cases of note illustrate both the ascension and expansive nature of tax qui tams:

1. <u>New York ex rel. Crossroads Analytic LLC v. Harbinger Capital Partners Offshore Manager, LLC, et al.</u>

In 2017/2018, whistleblower-initiated cases against a purported Alabama-based hedge fund and its New York investment advisor yielded a $70 million tax recovery for New Yorkers — the largest income tax qui tam in U.S. history. The government intervened in the action and the whistle-blower earned a 22 percent share amounting to $15.4 million.[2]

The lawsuit alleged a complicated scheme by the hedge fund to allocate 100% of its investment manager's income to Alabama, a state with a low tax rate, despite the fact that all of the taxable investment services were conducted in Manhattan, whereas only back-office operations were conducted in Alabama. The defendants in that case disregarded the advice of an outside accountant that income would be subject to New York taxation. One of the corporate executives even wrote that allocating all of the taxes to Alabama was "unsupportable" but *on the same day* sent an e-mail saying that the company "may get aggressive" in allocating its income to Alabama for tax purposes.[3]

---

[2] *See* Press Release, NYOAG "*A.G. Schneiderman Announces $40 Million Settlement With Investment Management Company For Tax Abuses, Marking Largest Tax Whistleblower Recovery In Office's History*" (April 18, 2017), https://ag.ny.gov/press-release/ag-schneiderman-announces-40-million-settlement-investment-management-company-tax (last visited Jan. 24, 2020); Press Release, NYOAG, "*A.G. Underwood & NYC Corporation Counsel Carter Announce $30 Million Settlement With Investment Manager For Tax Abuses*" (Sept, 27, 2018), https://ag.ny.gov/press-release/ag-underwood-nyc-corporation-counsel-carter-announce-30-million-settlement-investment (last visited Jan. 24, 2020)

[3] *See* Complaint, Index No. 100416/2015 (N.Y. Sup. Ct. 2015)

It was the first case that pierced the veil of tax secrecy of hedge funds, and represents a major expansion of state whistleblower enforcement to Wall Street activity.

2. New York ex rel. Empire State Ventures, LLC v. Sprint Nextel Corp., et al.

In 2018, a sales tax qui tam against Sprint-Nextel yielded a $330 million tax recovery. The government intervened in the action and the whistleblower earned a 19 percent share amounting to $63 million. The result obtained as a result of the whistleblower in this case was the largest qui tam recovery by any state.

The case involved a novel area of law: how telecommunications companies collect sales taxes on monthly flat-rate charges as opposed to how they collect taxes on interstate and intrastate phone calls that are billed by the minute.[4] Notably, despite passing repeated tax audits, it was a whistleblower that brought this scheme to the attention of authorities.

3. New York ex rel. Aniruddha Banerjee v, Moody's Corp., et al.

New ground was also broken last month with the announcement of an $8.5 million NYFCA tax qui tam recovery against Moody's Corporation and Marsh & McLennan. In that suit, the whistleblower alleged that Moody's had mischaracterized taxable income as premiums to its wholly-owned captive insurance subsidiary, and that Marsh aided and abetted the scheme. It was the first NYFCA tax settlement to be obtained *solely* by a whistleblower after the New

[4] *See* Press Release, NYOAG, "*A.G. Underwood And Acting Tax Commissioner Manion Announce Record $330 Million Settlement with Sprint in Groundbreaking False Claims Act Litigation Involving Unpaid Sales Tax*" (Dec 21, 2018), https://ag.ny.gov/press-release/ag-underwood-and-acting-tax-commissioner-manion-announce-record-330-million-settlement (last visited Jan. 24, 2020).

York Attorney General declined to intervene in the qui tam. The whistleblower was awarded with the maximum 30 percent of the award amounting to $2.55 million.[5]

In each one of these cases, complicated 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.

<u>NYFCA Tax Qui Tams: Effective Tax Administration</u>

Opponents of tax qui tams often suggest that tax qui tams should not be allowed because they are expensive and burdensome, will lead to abusive lawsuits, and interfere with tax administration by state tax departments. But the above evidence demonstrates that tax qui tams, coupled with effective enforcement, can be a necessary and important tool in effective tax enforcement.

The argument that tax qui tams *interfere* with traditional tax administration as opposed to *augment* has to contend with the unwavering support of tax qui tams by the New York State Department of Taxation and Finance ("DTF"), which supported the NYFCA legislation when it passed, and continues to support it to this day.

One special statutory provision of the NYFCA that facilitates cooperation and synergy among whistleblowers, the New York Attorney General, and the DTF is a special requirement

[5] See Press Release, Business Wire, "*Kirby McInerney Announces Settlement of Tax Whistleblower Case Against Moody's Corporation and Marsh*" (Jan. 8, 2020), https://www.businesswire.com/news/home/20200108005668/en/ (last visited Jan. 24, 2020).

that the Attorney General must "consult" with DTF prior to filing *or* intervening in a NYFCA tax fraud suit, and a requirement that the New York Attorney General must approve any proposed subpoena to DTF by a relator seeking tax records. *See* N.Y. State Fin. L. § 189(4)(b).

Further, the NYFCA's income and damage thresholds, while limiting the application of the NYFCA to tax frauds to complicated large-scale schemes, prevented a flood of small tax qui tams of the kind seen in Illinois. The Illinois False Claims Act allows sales tax qui tams against *any* defendant for *any* amount of damages. *See* 740 ILCS 175/1 et seq. (1991). This has lead to hundreds of small sales tax qui tams being filed against Illinois businesses, small and large. The situation resulted in the Illinois Attorney General dismissing several tax qui tams and calls to eliminate tax qui tams in Illinois.

Unlike the situation in Illinois, there are no calls to eliminate the thresholds under the NYFCA or, critically, the application of the NYFCA to tax frauds.

<u>Other Jurisdictions Are Taking Notice</u>

In the wake of New York's experience, other states have begun to look at *their* False Claims Acts to consider following New York's model. Last May, the California Assembly passed a provision closely modelled after New York's law, and similar legislation is pending in Michigan and in the District of Columbia.

Georgia, too, can expect to join this debate in the future. Georgia's False Claims Act was last updated in 2012, when Governor Nathan Deal signed the Georgia Taxpayer Protection False Claims Act into law. That statute expanded the lay of the land for whistleblowers in Georgia, by allowing potential qui tam suits in areas other than just Medicaid fraud, such as contracting and procurement fraud.[6] It is inevitable that proposals will reach Georgia to empower whistleblowers to protect its taxpayers by allowing tax qui tams.

Conclusion

Tax qui tams are here to stay — and likely to expand. As demonstrated in New York, complicated and novel tax frauds by major corporations, hedge funds, and financial institutions are ripe for continued discovery and exposure by whistleblowers.

[6] Relators must first obtain written approval by the Georgia Attorney General in order to file a qui tam for a fraud unrelated to the Georgia's Medicaid program. Ga. Code Ann. § 23-3-122(b)(1) (2020).