New York's *Qui Tam* Law: Jackpot Justice or Creative Tax Tool — or Both?

by Billy Hamilton

When two New York state tax experts, whose credentials are impeccable, both mentioned the same piece of legislation recently enacted by New York lawmakers, it seemed like a good idea to take a closer look to see what the fuss was about. The issue in question is New York's extension of the state's False Claims Act (FCA) to taxes.[1]

The law allows what are known as *qui tam* actions in tax cases. *Qui tam* is short for a Latin phrase, "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," which roughly translates to "he who brings an action for the king as well as for himself." According to one definition, it is "an action under a statute that establishes penalties for certain acts or omissions that can be brought by an informer or and in which a portion of the penalties, fines, awards can be awarded the whistleblower."[2]

The New York version of the *qui tam* law increases the protections and incentives for anyone who presents evidence of tax fraud against the state or one of its local governments. This is a new use of the *qui tam* concept. Previously, it has mostly been applied in cases of healthcare fraud. The New York amendments permit *qui tam* plaintiffs to bring actions for tax fraud when a defendant's net income or sales exceed $1 million and when damages to the state exceed $350,000. In effect, the law encourages whistleblowers to blow their whistles in tax cases against large taxpayers in exchange for 15 to 25 percent of any recovery or settlement. Although this is the first application of *qui tam* to tax cases, if it's successful, it probably won't be the last.

I first heard about the legislation, which lawmakers approved last August, when I talked to Bill Comiskey, former deputy commissioner of the Office of Tax Enforcement with the New York Department of Taxation and Finance. He recently left the state to work for the New York law firm of Hodgson-Russ LLP and is spending some of his first days on the job making presentations on the new law.

Shortly thereafter, I heard about the legislation again from Jim Wetzler, the former commissioner of the Department of Finance and Taxation and now a partner with Deloitte in New York. I had polled several people on state tax issues that should be included in a year-end state roundup I was writing. He told me:

> In New York, in a generally uneventful year, the top story may turn out to be a sleeper. In August, largely unnoticed, the Legislature extended the state's False Claims Act to tax claims, opening up the prospect of *qui tam* lawsuits against large taxpayers who a trial lawyer thinks might have underpaid state tax. Depending on how this is administered, it could lead to lots of litigation outside the normal tax administration process.

So what's going on with this New York sleeper issue? It's a story that's been developing longer than you might imagine and begins, as do so many controversial issues involving government power, with the federal government. The New York FCA, like similar statutes in at least 26 other states and the District of Columbia, is modeled on a federal law that dates back to the Civil War.

The federal False Claims Act, originally known as the "Informants' Act" or "Lincoln's law," was enacted in 1863 to combat fraud perpetrated by companies that sold supplies to the Union Army. The schemes

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[1]NY State. Fin. Law, ch. 13, sections 187-194.

[2]*Qui tam* actions were first used in 13th-century England as a way to enforce the king's laws. They existed in the United States in colonial times and were embraced by the first U.S. Congress. The practice fell into disrepute in England in the 19th century, by which time it was principally used to enforce laws concerning Christian Sunday observance. It was brought to an effective end by the Common Informers Act. The term "whistleblower" is of more recent vintage. It derives from the practice of English "bobbies," who blow their whistles to signal a crime, alerting both law enforcement officers and the general public to the potential danger.

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were extensive and creative. For example, war profiteers were shipping boxes of sawdust instead of guns and tricked the Union Army into repeatedly purchasing the same cavalry horses. "You can sell anything to the government at almost any price you've got the guts to ask," one profiteer is reported to have boasted. He made his fortune selling moth-eaten blankets to the Union.

It was called "Lincoln's law" because President Abraham Lincoln was a major advocate. The law contained *qui tam* provisions that allowed private citizens to sue, on the government's behalf, companies and individuals that were defrauding the government. Those who filed lawsuits were known as "relators," a term still used today. The law fell into disuse after being emasculated in the 1940s, but it was revived in the 1980s amid reports of widespread fraud in Defense Department contracting; this was the era of the $640 toilet seats and $435 hammers. Frustrated by the government's inability to scotch the abuses, Congress revised the federal False Claims Act to encourage more whistleblowers to come forward. Congress also created incentives for private attorneys to use their own resources to investigate fraud. President Ronald Reagan signed the overhauled act into law in October 1986.

Although it's the basic model for the New York FCA, the federal law has always explicitly excluded tax fraud. That doesn't mean that the feds ignored tax evasion, but rather that they kept tax matters separate from the false claims provisions. As early as 1867, the federal government had a law allowing payments to individuals supplying information for "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same." The law wasn't much used. Rewards were low compared with the federal False Claims Act, and the IRS historically was hesitant about using whistleblowers. Thus, although recoveries in whistleblower cases under the False Claims Act grew exponentially after the 1986 amendment — from $390,000 in 1987 to more than $1.1 billion in 2005 — recoveries by the IRS whistleblower program hadn't even reached $100 million (including taxes, penalties, and interest) in the same time frame.

That began to change in 2006 when the IRS statute was overhauled to put more teeth in it, enabling private individuals to report taxpayers guilty of violating the tax laws. The IRS whistleblower law, like the False Claims Act, rewards whistleblowers who report allegations of fraud against the government. In general, a whistleblower can receive an award of between 15 and 30 percent of the collected proceeds, including penalties, interest, additions to tax, and additional amounts. The law, however, still doesn't include a *qui tam* provision, among other differences with the False Claims Act.

At the state level, laws modeled on the False Claims Act have multiplied in the last decade. Most *qui tam* cases at the state level are about healthcare fraud, mainly in the massive Medicaid program.[3] Many of the state settlements to date have come from piggybacking on federal law enforcement efforts in Medicaid and Medicare fraud cases and joining in global settlements. The statutes are, however, potentially more flexible than their current uses would suggest. Most state false-claims statutes cover state programs generally and not just Medicaid, although some are restricted to healthcare fraud alone.

Until New York's recent change, however, the states also mirrored the federal convention of separating the false-claims process from tax fraud provisions. Like the federal government, several states have enacted legislation that allows bounties to be paid to whistleblowers for information that leads to the exposure of tax law violations. Just how many states that might include is a little foggy. One tax whistleblower blog (of course they exist) reported in 2009 that seven states — California, Delaware, Florida, Illinois, Indiana, Nevada, and Rhode Island — had passed some form of tax whistleblower law.[4] Some include income taxes — California, Delaware, Florida, and Nevada — and the rest restrict claims to other types of taxes, such as the sales tax. None include anything like a *qui tam* provision. Also, the problem with the list is that it should include at least one more state — Texas — which has had its own whistleblower provision since 1991.[5]

The New York law change took the whistleblower concept to a new level by marrying the FCA with tax enforcement. The state initially adopted its version of the federal False Claims Act in April 2007. The original statute didn't include taxes but allowed the state and local governments to bring a civil action to recover three times its financial losses from fraud. It also allowed private citizens with inside knowledge of a fraud to bring a *qui tam* action on behalf of the government and to receive up to 30 percent of any resulting proceeds. Other than taxes, the legislation covered all kinds of fraud, including healthcare, government construction, roads and bridges, prisons, housing, the environment, and so on.

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[3]Finch McCranie LLP, "States' Experiences With Their Own False Claims Acts," Part 6 of a six-part article, "Special: Article Explaining the 2010 False Claims Act and State False Claims Acts," *Whistleblower Lawyer Blog*, Dec. 10, 2010, *available at* http://www.whistleblowerlawyerblog.com/.

[4]Tax Whistleblower Blog, "States That Offer Whistleblower Rewards," Apr. 24, 2009, *available at* http://taxwhistleblowerblog.com/page/2.

[5]Texas Government Code, section 403.0195.

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As a result of the amendments signed into law last August, New York's law became the most far-reaching in the country by extending the FCA to tax fraud under defined conditions. Other provisions of the FCA were left unchanged.

> ***The new amendment increases protections for* qui tam *whistleblowers against retaliation.***

As it applies to taxes, the act has three major provisions. First, it extends the New York FCA to false claims, records, or statements under state tax law as long as the net income or sales of the person — which includes partnerships, corporations, associations, and other legal entities — exceeds $1 million for any tax year and the damages alleged in the action exceed $350,000. If those requirements are met, a defendant faces potential false-claims penalties of three times the amount of the tax underpayment, plus $6,000 to $12,000 for each false claim, record, or statement. In an action brought under the FCA, the defendant doesn't have to have knowingly or intentionally violated the tax code. A false tax return submitted in "reckless disregard" of the law is sufficient. Although the $1 million net income threshold excludes most individual taxpayers, the law has more far-reaching implications for business taxpayers.

Second, the new amendment increases protections for *qui tam* whistleblowers against retaliation. The protections extend to:

> any current or former employee, contractor, or agent of any private or public employer who is discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against in the terms and conditions of employment, or otherwise harmed or penalized by an employer, or prospective employer, because of lawful acts done as part of an action brought under the law.

That's a wide net, and significantly, it includes public agencies as well as private.

Finally, some commentators think that the most significant change to the law is the immunity — some say encouragement — it gives to current employees, contractors, and agents who steal confidential or otherwise sensitive documents from their workplace to help prove claims against their employers. The law's definition of a lawful act includes "obtaining or transmitting to the state, a local government, a *qui tam* plaintiff, or private counsel solely employed to investigate, potentially file, or file a cause of action under [the FCA], documents, data, correspondence, electronic mail, or any other information." That immunity applies even if removing the materials violates "a contract, employment term, or duty owed to the employer or contractor." The law attempts to prevent abuses under the provision by limiting it to "efforts to stop one or more violations of [the FCA]," but some of the critics I read share Wetzler's concern about the size of the can of worms that may be opened. Also, the provision appears to apply equally to private and public employees, leaving open the question of what happens if a government worker steals public documents for the benefit of a public whistleblower action.

Obviously, those issues will take time to sort out. In the meantime, the bill's authors see it as a breakthrough in the eternal struggle to close the tax gap. Greg Krakower, special counsel to the majority of the New York Senate, who helped draft the amendments, recently told a writer for the blog *FCA Alert*: "New York is the one jurisdiction in the country that allows individuals to bring actions for tax fraud."[6] He said that courts construing the exclusion of tax claims under the federal law have concluded that the separation was designed so that the IRS could enforce the Internal Revenue Code as it sees fit. The New York tax authorities, he said, aren't so territorial. Krakower also said that he anticipates that *qui tam* relators for tax fraud claims will include accountants, bookkeepers, employees of banks, accounting firms, and other businesses that handle tax matters.

However, Krakower said that return preparers or executors who file returns on behalf of estates won't put themselves at risk under the law unless they themselves knowingly file a false claim or make a false statement. He also said that the amendments don't create a false-claims liability simply because a taxpayer fails to pay taxes or file tax returns.

Looking at the law from the viewpoint of a former tax administrator who now represents taxpayers in state tax disputes, Wetzler was less enthusiastic about New York's innovation. He said:

> The tax administration process in the U.S., New York, and most other states traditionally has been a nonpublic, bilateral relationship between the taxpayer and the tax administrator. In this relationship, taxpayers have certain rights, including a well-specified appeals process and non-disclosure of their tax return information. The tax administrator makes interpretations of the statute that, presumably, balance the various policy objectives of the government for which he or she works. A good tax administrator sets enforcement priorities that balance the need for revenue against the

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[6]Brendan Cyr, "NY False Claims Act Reaches Tax Fraud," *FCA Alert*, Kelley Drye & Warren LLP, Oct. 18, 2010, *available at* http://www.fcaalert.com/2010/10/articles/legislation-amendments/ny-false-claims-act-reaches-tax-fraud/.

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> costs of collecting that revenue and the burdens imposed on taxpayers. The new law creates an alternative tax administration process in which taxpayers don't have many of the rights that exist in the normal tax administration process and in which the attorney general has the right, in specific cases, to override the tax administrator's decisions about enforcement priorities and how to interpret the law. It's not good for tax administration in New York, and certainly not for taxpayer rights.

But, coming from a tax enforcement background — and before that, from a long career in criminal prosecution — Comiskey believes the law will be a valuable new tool for administrators. He told me:

> New York's expansion of the False-Claims Act is good for New York and good for tax administration. And it is one that virtually no tax professionals even know about yet. While there have been some claims of abuses of the federal False-Claims Act, the evidence is overwhelming that the act has proven its value in other areas and has helped government recover billions that would otherwise have been lost to fraud. There is every reason to think that it will have a comparable impact in the tax area. It will lead to significant recoveries, it will shine a light on major tax abuses that are unknown to government, and it will change taxpayer behavior for the better. It is, as others have observed, the most powerful tool that government has for penetrating complex schemes to defraud the government. Why shouldn't we have the benefit of such a tool in the tax area, especially given New York's annual multibillion-dollar tax gap?

Comiskey said that the new law includes provisions that address Wetzler's concerns as well as others that have been raised about the act. "The statute calls for the Tax Department to have a key role in false-claims act cases," he said. "Cases are filed under seal and are not made public until they have been vetted by the attorney general and by the department. Moreover, although in the context of a civil lawsuit and not an administrative proceeding, taxpayers who are sued certainly have due process protections in the context of those lawsuits." He pointed out that because the burden of proof will be on the person bringing the *qui tam* lawsuit, it's possible to argue that taxpayers will have even greater protections in the false-claims area than they do in issues before state tax administrators. Also, he emphasized the monetary thresholds for bringing a suit. The relatively high net income floor means that the state is interested in high-dollar fraud and won't touch most taxpayers.

Comiskey said:

> I really don't think that this new statute will undermine the department's role in tax administration. Indeed, the department supported this bill. As we all know, enforcement priorities set by a tax agency often turn on a host of practical and policy factors, including the level of available enforcement resources, the difficulty of the cases to be examined, the level of information available to the government prior to the examination, etc. No agency has the level of resources needed to identify and pursue all the fraud that exists, especially when the fraud is hidden in a complex web of structured transactions. The False-Claims Act will provide the state with the best tool available to expose these schemes. It's a law that should be welcomed by honest taxpayers and businesses.

Comiskey also said that because the law is new to New York and the states generally, he expects many interesting issues to emerge during the coming months. "Will whistleblowers who have filed under the IRS whistleblower program now file in New York? How aggressively will Attorney General Eric T. Schneiderman seek tax cases? Since he wrote the new law, my bet is that he is going to be aggressive," Comiskey said.

That may be true, but I have to wonder about Comiskey's point about honest taxpayers and businesses welcoming the law. In my experience, taxpayers — and particularly business taxpayers — are leery of any aggressive new enforcement tools, fearing that whatever the new approach is could be applied too broadly and too indiscriminately: a case of the elephant dancing and the mice, albeit the very large mice, getting nervous. If anything, this is especially true in tax enforcement, which involves a far greater range of potential targets than, say, Medicaid provider fraud. A sum of $1 million in net income sounds like a lofty barrier until you consider just how many business taxpayers have far more income or sales than that and are still considered small businesses.

> ***In the minds of many tax administrators, whistleblower laws, even without a* qui tam *provision, have always been a little dubious.***

In my experience, whistleblower laws, even without a *qui tam* provision, have always been a little dubious in the minds of many tax administrators. In the 16 years I was involved in tax administration, the Texas disclosure law allowing bounties to be paid for evidence of tax evasion has been around for nearly 20 years but was used in only a handful of cases. Possibly that was because the law was poorly advertised and understood, but I sensed that our tax

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staff was a little queasy about dealing with whistleblowers generally, on the grounds that the effort required to make a case — which often was significant — wasn't worth the payoff. Other factors also may have been involved. Informants often turned out to have a grudge to settle or simply wanted to use the information they had to reap a payday at a former employer's expense. The process was long and time-consuming, and it seldom worked out to everyone's satisfaction. Resources could be better used elsewhere. A measure of the implicit attitude about the program can be seen in the fact that our staff often referred to the legislation as the "snitch bill."

Texas apparently isn't alone when it comes to administrators dragging their feet in the use of whistleblowers. A recent commentary from California noted: "Years ago the California State Legislature passed legislation enabling both the Franchise Tax Board and Board of Equalization to reward whistleblowers for information leading to the recovery of unpaid income, sales or use taxes. But it seems those programs were mothballed even before they were launched."[7]

The IRS also has had issues with its whistleblower law. Writing on the possibility of extending *qui tam* provisions to federal taxes, American University law professor Dennis Ventry recounted this story:

> In 1998, as Congress listened to sensational testimony of abuse and coercion by Internal Revenue Service agents — nearly all of which turned out to be false or grossly exaggerated — Senator Harry Reid, D-Nev., was fuming mad. In addition to encouraging its revenue agents to engage in intimidation tactics, the IRS was enlisting taxpayers in overzealous collections efforts by rewarding them for retaliating against alleged tax cheats. In an informant program that he dubbed the "Reward for Rats Program" Reid told Congress that the IRS was paying "snitches to act against associates, employers, relatives, and others — whether motivated by greed or revenge — in order to collect taxes."[8]

[7]Erika Kelton, "Opinion: Bridge the tax gap: Bring in the whistleblowers," *Capitol Weekly*, May 6, 2010, *available at* http://www.capitolweekly.net/article.php?xid=ytjx468l0v1dkc.

[8]Dennis Ventry, "Whistleblowers and *Qui Tam* for Tax," *Tax Lawyer*, Vol. 61, p. 357, 2008, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020182.

Reid urged his colleagues to abolish the program. Instead, they expanded it only a few years later, in 2004, because the interest in closing the tax gap and adding revenue trumped any ethical qualms that might have troubled Congress as a whole.

In his article, Ventry argued that the application of *qui tam* to federal tax law is a vital way to overcome the real limitations on effective tax enforcement:

> Allowing private citizens to prosecute alleged tax abuses in the form of *qui tam* litigation would inject an additional element of risk into a taxpayer's evaluation of how to comply with the tax law, and could greatly alter tax compliance norms within organizations, deterring overaggressive tax planning at the source. Private enforcement and prosecution of public law can be an especially effective compliance mechanism in the area of tax regulation, where tax officials face unusually steep information deficits, active concealment by taxpayers, and insufficient resources to enforce the tax laws.

Similar arguments would apply equally to similar state laws, but other considerations also may provide added motivation. Comiskey told me that New York expects to recover about $20 million a year through its new statute, and if the law is a success, we will likely see other states — many of which are desperate for revenue — copy the concept. Maybe New York is on to something that will provide an important new tool for tax administration. Maybe it's a logical extension of a public policy geared to the ethical realities of the modern world — a period that sees whistleblowing as a bulwark against otherwise undetectable financial chicanery. And of course, we've always admired the people who step bravely forward to expose wrongdoing by the powerful. Nevertheless, it seems to me that the issue becomes far more ambiguous when the whistleblowing turns on the prospect of outsized financial reward. In this kind of situation, government must be careful that it doesn't descend into what *Forbes* magazine called the "hell-bent pursuit of jackpot justice." Possibly I'm old-fashioned, but the whole issue strikes me as skating on pretty thin ice ethically. But success often sweeps aside fusty objections. Jackpot justice or innovation in tax administration? Time will tell. ✰

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