Perspective

Tax Policy

Randall M. Fox, a partner at Kirby McInerney LLP and former Bureau Chief of the New York Attorney General's Taxpayer Protection Bureau, is a proponent of state qui tam tax claims—a whistleblower law that allows private citizens who allege tax fraud to sue on the government's behalf. Many state and local tax practitioners say *qui tam* tax claims should be excluded from False Claims Acts as the federal government does. Six of 29 states (Delaware, Florida, Nevada, New Hampshire, New Jersey and New York) that have implemented an FCA don't include a tax bar. Three of the 29 states (Illinois, Indiana and Rhode Island) have partial tax bars, disallowing income tax claims.

The Case for *Qui Tam* Tax Claims: Former New York Attorney General Bureau Chief Tells Why States Should Lift Their Bar

RANDALL M. FOX, INTERVIEWED BY EAN HAMILTON

Randall M. Fox is a partner at Kirby McInerney LLP's New York office, focusing on whistleblower, antitrust and consumer fraud matters. Before joining the firm in 2014, Fox served as the founding Bureau Chief of the New York Attorney General's Taxpayer Protection Bureau. The Bureau handles claims that the government was defrauded, including those brought by whistleblowers. Before being promoted to Bureau Chief, Fox was a special assistant Attorney General in the New York Attorney General's Medicaid Fraud Control Unit, where he handled health-care fraud cases.

BLOOMBERG BNA: What is the strongest argument in support of whistleblower statutes applying to taxes? How do you respond to the argument that whistleblower statutes shouldn't apply to taxes?

FOX: Incentivizing whistleblowers is an effective tool for fighting fraud and protecting our tax dollars. This fact has been demonstrated repeatedly, most recently by the fact that the federal government has recovered tens of billions of dollars in the last several years through whistleblower cases brought under the False Claims Act. In the tax arena, whistleblowers can and do provide the same service of protecting the public fisc by reporting on tax frauds. When I worked for the New York Attorney General, I saw tax whistleblowers who came forward with information about legitimate issues of likely tax evasion that the government did not already know about and that would likely have gone un-

noticed but for the whistleblower. Tax whistleblowers are particularly useful because they can bring the government focused information about particular misconduct. The process of investigating such specific claims is almost always more efficient and effective than conducting generalized audits to look for needles in haystacks. Overall, encouraging whistleblowers with financial incentives to shine light on concrete claims results in better tax enforcement.

The argument I have heard repeatedly against having tax whistleblowers is that tax law is different from other areas of law because it is so complex. But tax is not alone in having complexity. There are complex issues in Medicare law and government contract law, both of which are areas where False Claims Act cases have been very successful. It is also true that many violations of tax law do not involve any real complexity. The majority of the tax whistleblower cases I saw at the Attorney General's Office did not. Where the issues raised in a tax *qui tam* case are truly complex, it is often very helpful to the government to have a knowledgeable whistleblower who can wade through and explain the complexity.

BLOOMBERG BNA: Why do you think the federal government included a tax bar in its FCA? Do you think this was a mistake?

FOX: The legislative history does not answer the question of why the tax bar was imposed. It was made explicit only in 1986, but that appears to have codified the earlier common law. But whatever the legislators' thinking was, I would argue that any missed opportunity to protect tax dollars through effective, efficient and fair means is a mistake.

The federal False Claims Act, by its terms, shall *not* apply to violations of the tax laws. In New York, the 2010 amendments to the False Claims Act, which were authored by now-Attorney General Eric Schneiderman, rather elegantly took out the word ''not'' so the act *shall apply* to violations of the tax law. The short history of the New York law has shown that it can be very effective, so perhaps the time is ripe to roll out the same program at the federal level.

It is important to note that the federal government has a tax whistleblower opportunity. The IRS whistleblower program offers financial incentives to persons who report not just outright tax fraud, but also inaccurate tax filings. That program does not follow the same litigation-based model as the False Claims Act, and it has come under some criticism as being slow, nontransparent and unaccountable, but the same core idea of an incentive for reporting is present there.

BLOOMBERG BNA: Isn't it the job of state tax revenue agencies to monitor taxpayers and to uncover tax fraud through audits, instead of relying on private individuals to uncover tax fraud? Don't you think state revenue agencies have enough resources and enforcement powers to do this?

FOX: State revenue agencies, just like state procurement agencies and state health agencies, have as one of their many duties to look for and combat fraud affecting their programs. There are never enough resources for any of them to fully satisfy that mission. At the federal level, Treasury Secretary Jack Lew recently testified before Congress that the lack of resources being allocated to the IRS is creating serious long-term risk for the U.S. tax system because lack of funds means there cannot be enough enforcement. The same constraints are felt at the state level, but unlike most state revenue agencies, the procurement agencies and health agencies have had their efforts supplemented through the efforts of whistleblowers.

The fundamental question in thinking about tax enforcement options is: How do we best protect the integrity of our tax system? Where only a small percentage of taxpayers can be audited and where auditors can be misled to miss tax evasion, the quest for fair, effective enforcement can only be helped by harnessing the power of people with specific knowledge by giving those people an incentive to come forward. Then we can move from a catch-me-if-you-can mentality to one where the risks of noncompliance are simply too high.

BLOOMBERG BNA: As you know, it's common in state tax for there to be a lack of guidance on basic areas. Is it fair to apply whistleblower provisions to tax cases given that there are so many gray areas?

FOX: It is fair to say that there are many tax rules that are perfectly clear, whether or not supplemental guidance has been given about them. Take for example the case that the New York Attorney General's Office settled with Mohan Custom Tailors. In that case a whistleblower reported that a retail business had kept sales tax money for itself rather than remitting it to the government. In the settlement, the government recovered $5.5 million, which was a multiple of the taxes owed, and the defendant pled guilty to a crime and agreed to jail time. That was an effective use of the tax *qui tam* provision, and there was no legitimate question about how the tax law applied. Was this a fair use of the whistleblower law? Yes.

The arguable existence of some gray areas in tax law does not militate against having a tax *qui tam* provision at all. Rather, it means that the facts of a particular case matter, and that bromide is true for tax cases and nontax cases alike. One element of a False Claims Act violation is that the defendant has acted with ''knowledge'' in violating the law. If the rules or obligations that the defendant allegedly violated were unclear, it is that much more difficult to establish that he or she committed the violation with knowledge. In each case, you need to look at the rules or obligations at issue and what the defendant did or thought with respect to them.

BLOOMBERG BNA: I'd like to get your reaction and response to a quote by Eric Tresh, a partner with Sutherland Asbill & Brennan in Atlanta, who I interviewed for my recent blog post on *qui tam* tax cases: ''Plaintiff attorneys and others are trying to extract settlements so that they get paid. . . forcing taxpayers to either spend significant sums of money defending their positions or paying off the plaintiffs. I liken it to extortion.''

FOX: I expect we can all agree that there are people and companies that are illegally evading taxes, and maybe we can agree that it is societally useful to have enforcement mechanisms that root out such frauds. It appears that Mr. Tresh takes issue with the fact that whistleblower statutes use a financial incentive to encourage people with knowledge to come forward. But he has not offered an alternative to this time-tested incentive. Interestingly, money tends to be the motivation for illegal tax evasion in the first place, so it is hardly surprising to use money as a motivation to fight against tax evasion.

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The quoted language also might be read to suggest that whistleblowers have sole control of cases they bring on behalf of the government (and can thus somehow ''extract'' settlements). The facts are a bit different. *Qui tam* whistleblowers must first bring their cases to the government, and the government has an opportunity to investigate and decide whether to convert the action into a government enforcement action. In a tax case, the New York Attorney General cannot convert a case into an enforcement action without first consulting with the New York State Department of Taxation and Finance, and, as a matter of practice, the Attorney General's Taxpayer Protection Bureau works very closely and very well with the department on tax *qui tam* cases. The Attorney General's Office can also seek to dismiss abusive cases. Even where the government turns down a tax case and the whistleblower proceeds with it (which has been very rare to date), the Attorney General serves as a gatekeeper for the whistleblower's access to tax records. The upshot of these procedures is that the suggested scenario is quite unlikely.

BLOOMBERG BNA: How do you respond to the idea that by not including a tax bar in state FCAs, it leaves the door open for opportunistic attorneys to pursue *qui tam* cases in complex areas of tax law in hopes of forcing a settlement because the cost of litigation will exceed the taxes owed by the taxpayer facing the fraud allegations?

FOX: Most lawyers who are of the mind-set you describe will likely be sorely disappointed if they bring tax *qui tam* cases. Claims under the False Claims Act are for the benefit of the government and provide an incentive in the form of a percentage of the recovery to the whistleblower. The whistleblower cannot bind the government. This involvement of the government makes unrealistic the notion that the whistleblower's attorney can unilaterally force a settlement. Moreover, cases are won or settled on the facts, not by throwing around words like ''complexity.''

BLOOMBERG BNA: In your previous position as the head of the New York Taxpayer Protection Bureau, were the whistleblowers for *qui tam* tax cases actual insiders with knowledge of fraud, or outsiders who stumbled upon instances in which a company has incorrectly interpreted or misapplied a tax law? For example, making online purchases to see if a company charges sales tax and if the company does not, file a whistleblower action?

FOX: There is a body of literature that seeks to draw a distinction between insider and outsider whistleblowers and to make the value judgment that insiders are better. I don't agree with that dichotomy. When I was Bureau Chief, I was presented with cases from both insiders and outsiders, and what was always most important to me was not which category the person may have fallen into, but the quality of the evidence. Sometimes insiders had better quality information, but sometimes outsiders were spot on. Either way, if the information demonstrated that a fraud had been committed against the taxpayers, I wanted to know.

BLOOMBERG BNA: Do you think recoveries by states from FCA claims are an easy way for states to raise revenue?

FOX: False Claims Acts provide an effective way to fight fraud, recover money and deter violations. Cash strapped states need to use every resource they have to increase revenues to pay for government services. FCA cases do involve time and risk, but implementing a False Claims Act is a wise investment. One recent study showed that the federal government has recovered about $20 for every $1 it spent on the resources necessary to pursue False Claims Act cases. Similarly, in its slightly more than three-year history, the New York Attorney General's Taxpayer Protection Bureau has recovered tens of millions of dollars for New York taxpayers, which represents a large multiple of the office's investment in the Bureau.

BLOOMBERG BNA: If a tax bar is not the answer, is there a way to weed out the opportunistic attorney who is trying to take advantage of FCAs that do not bar tax claims? What about excluding specific tax issues that are known to be unsettled from *qui tam* litigation, i.e. responsibility of remote sellers to collect sales and use tax?

FOX: If we could find a way to weed out opportunistic tax frauds, there would be little reason to give financial incentives to report on them. If the question is how we prevent meritless and abusive tax *qui tam* cases, then the answer lies within the New York False Claims Act itself. The act is framed to avoid abuses because it excludes smaller tax claims and it involves not only the Attorney General's Office but also the Department of Taxation and Finance, and it makes the Attorney General's Office a gatekeeper for access to tax documents even when the government declines to take on a tax case.

The idea of excluding certain issues from *qui tam* treatment promises more mischief than assistance because it is not possible to clearly define what is ''known to be unsettled.'' To use the example from the question, it is not the case that every issue about remote sellers' obligation to collect sales or use taxes is unsettled. In fact, one company that purported to be a remote seller, but nevertheless had a clear presence in New York for tax nexus purposes, recently settled a New York tax *qui tam* case for multiples of the taxes due (though in that case, it was corporate franchise taxes, not sales taxes). The question of whether there is clarity in the particular rules and obligations that arise in a case is much better determined on a case-specific basis.

BLOOMBERG BNA: Do you have any predictions for the future on whether states will amend their FCA statutes to explicitly include tax claims given the rise in *qui tam* tax claims in states such as New York and Illinois?

FOX: Good examples breed imitation, and these *qui tam* programs provide good examples. Overall, having tax *qui tam* statutes is a wise investment for a state both for the tangible recoveries that result from judgments and settlements, and the less tangible benefits of the compliance that results from more effective enforcement. What any given state chooses to do is a political question, but I would submit that the implementation of tools that protect the integrity of the public fisc is a nonpartisan issue with great upside potential for a state and its citizens.