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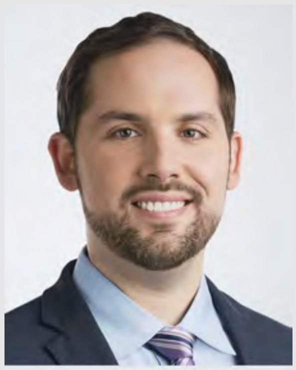

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In this article, Rillotta and Herbert examine the trend of state attorneys general getting increasingly involved in tax enforcement through False Claims Act cases.

Most white-collar defense attorneys have done at least some work in the False Claims Act (FCA) area. Most tax controversy attorneys, thus far, have not. This could be changing.

Several states — and, most recently, the District of Columbia — are leading the charge to bring FCA claims based on evasion of income tax. These efforts have introduced a new creature into the tax enforcement ecosystem: the state attorney general's office. And, like so many ecologists meticulously tracking the latest movements of the spotted lanternfly,[1] tax practitioners are trying to get their arms around how exactly this new tax enforcement species will change the environment we know.

The Unique Procedures and Dynamics of FCA Cases

We will come back to the spotted lanternfly, but first, let's start with the basics. The federal FCA and the state counterparts[2] are statutes that generally provide civil liability (and treble damages) for any person who knowingly submits a false claim to the government. The federal statute was enacted in 1863 in response to defense contractor fraud during the Civil War. Most FCA statutes are broad by design, encompassing just about every imaginable fraud on the government — so, substantively, this is terrain in which white-collar practitioners comfortably tread. Procedurally, the FCA can be conceptualized as a kind of hybrid: civil litigation rules superimposed on what is essentially criminal case subject matter — and there is some truth to this. Were it not for the FCA, many white-collar attorneys would long ago have relegated the Rules of Civil Procedure to the same musty recesses inhabited by the rule against perpetuities and the doctrine of attractive nuisance. Yet, more precisely, an FCA case is really a *sui generis* proceeding.

Though the government can bring a claim on its own, an FCA case usually starts with a whistleblower complaint (called a *qui tam* suit). A *qui tam* suit is technically filed on behalf of the government by the whistleblower, who is formally called the "relator." The complaint is filed under seal and so is secret at the onset. Indeed, rather than kicking off litigation as a civil complaint typically does, the court effectively freezes a *qui tam* FCA case soon after filing, before the complaint is even served, to give the

[1] *See, e.g.*, Benji Jones, "Blowtorching Spotted Lanternflies Is, in Fact, a Bad Idea," Vox, Sept. 16, 2022.

[2] We acknowledge the political sensitivities around lumping the District of Columbia together with "states." Nevertheless, for ease of reference and, we hope, with the indulgence of D.C. statehood advocates, we are going to include the District's False Claims Act in our discussion of state FCAs.

government an opportunity to investigate the matter and vet the whistleblower's allegations. The government investigation phase, in many respects, mimics the ebb and flow of a criminal investigation, with civil investigative demands (or some similarly styled mechanism, depending on the jurisdiction) standing in for grand jury subpoenas and imbuing the government with broad discovery powers. The investigation is usually followed by the unsealing of the complaint and the resumption of civil litigation, which effectively plays out like a sort of three-party dance: The relator and the government often work together — to varying degrees, depending on the government's assessment of the relator's case — to seek to recover punitive financial damages from the defendant.[3]

In essence, the government serves a sort of gatekeeping role in an FCA case. It can decide to intervene and run the case; to intervene and dismiss the case; to decline intervention and leave the litigation to the relator; or to defer its decision pending further investigation or case developments. Obviously, the role that the government chooses to play has a significant impact on the trajectory of the case. Because an FCA case is the government's case at the end of the day — with the relator merely suing in the government's name — it is primarily the government's prerogative to settle or otherwise dispose of the case short of trial. However, the relator can object if it deems the resolution unfair, and the court ultimately has to sign off on any settlement. If the plaintiff prevails, the relator gets a percentage of any monetary recovery, and typically also attorney fees and costs.

As with much in the law, there are familiar yet invariably case-specific dynamics permeating FCA matters. Putative whistleblowers seem to be *everywhere*, some with righteous motivations, others with . . . less righteous motivations, and virtually all offering the government insight into the evidence that it would otherwise be difficult to obtain. Whistleblowers and their lawyers are not ambivalent to political and government enforcement trends, but relators are not beholden to government enforcement priorities, either. Whistleblowers are an independent faction, if you will, with their own motivations and views of the facts, empowered by these statutes to, in many ways, set the tempo of prosecution; and sometimes they can put the government gatekeepers in awkward situations. Other times, the gatekeepers and whistleblowers comfortably align, combining the relator's insider knowledge of the facts and the gravitas of government enforcement in a forum where a substantial penalty can be imposed based on a preponderance of the evidence.

Historically, tax attorneys have not had to worry too much about whistleblower-driven penalties litigation. Yes, the IRS has had various whistleblower programs over the years. And yes, in some tax cases, informants have played critical roles and been invaluable to government agents and attorneys. But, at least at the federal level, whistleblowers have not been able to initiate and put their shoulders behind tax fraud cases in the same way they have, say, with healthcare fraud or procurement fraud. This is because the federal FCA carves out from its provisions "claims, records, or statements made under the Internal Revenue Code."[4]

Some state FCAs, however, have no such exceptions. So it is at the state level that tax-based FCA enforcement has begun to gain traction. In a growing number of states, the FCA gatekeepers — the offices of the attorneys general — appear to have enthusiastically embraced the trend.

Tax-Based Claims Under State FCAs

Many states originally modeled their FCAs on the federal statute, incorporating the *qui tam* structure and an express bar on tax-based claims. However, laboratories of democracy that they are, other states went their own way. Some — for instance, Texas and Michigan — cast their FCAs more narrowly, limiting scope to particular subject matters, such as fraud in healthcare programs. Other states went broader than the federal act.

Most pertinently, in 1994 Florida quietly enacted a law that largely tracked the federal

[3] For the fiscal year ending September 30, 2021, the U.S. Justice Department obtained more than $5.6 billion in settlements and judgments.

[4] 31 U.S.C. section 3729(d).

FCA, except that it contained no bar on tax claims.[5] Illinois followed with an FCA provision that allows some tax-based claims, including claims for evasion of sales tax, but not claims related to income or property tax.[6] Indiana and Rhode Island implemented similar middle-way provisions, allowing some but not all tax-based claims.[7] Nevada's FCA was silent on the issue, but in 2006 the state's supreme court held that the statute could generally be used to bring tax-based claims.[8]

Then came New York. In 2010, New York became the first state to amend its FCA to expressly include claims for evasion of income tax (and other types of tax), provided that: the net income of the defendant equaled or exceeded $1 million for any year in question; the damages pleaded exceed $350,000; and the alleged misconduct consisted of the filing of a false claim, statement, or record with the state.[9] Practically speaking, the New York law effectively limited FCA cases to high-income taxpayers that actually filed false tax returns — most failure-to-file and *Spies* evasion-type fact patterns[10] were not covered — but this was the only real subject matter limitation.[11] New York rolled out its law with some fanfare. The attorney general's office established a Taxpayer Protection Bureau in 2011, and in the ensuing decade, it intervened with gusto in a number of high-profile FCA tax cases — for instance, touting a "groundbreaking" suit in which it recovered $330 million from Sprint based on sales tax owed on flat-rate wireless plans,[12] and a $30 million recovery from hedge fund managers for apportioning their income out of state.[13] The Taxpayer Protection Bureau has experienced setbacks, too, particularly when it has pushed claims in more ambiguous areas of tax law.[14] Still, New York's attorney general continues to frame the FCA as a critical part of the state's tax enforcement efforts, announcing more recent cases against an auction house, a sports memorabilia retailer, and yet more hedge fund managers.[15] In further statements, the attorney general has suggested that New York's FCA tax provisions could next be turned to cryptocurrency traders.[16]

In all events, New York's enthusiastic FCA tax enforcement seems to have provoked some conversation. In 2018 Delaware enacted an FCA without any kind of tax bar.[17] Several other states have advanced legislation to similarly amend their FCAs, including Michigan, Connecticut, Ohio, and — most notably — California. There has also been a backlash of sorts, a contingent of commentators and business advocates who assert that the complexities of tax enforcement are better left to specialist revenue authorities to resolve, rather than whistleblowers and (often elected or politically motivated) attorneys general. In Illinois, this faction introduced legislation to try to reimpose a tax bar in the FCA.

But the most recent developments go to the proponents of FCA tax enforcement. On January 13, 2021, the District of Columbia enacted an amendment to its FCA modeled on the New York law.[18] When the period for congressional review of

[5] Fla. Stat. Ann. sections 68.081-68.092. It is worth noting that, like Florida, a number of the jurisdictions that currently have no bar on tax claims in their state FCAs also have no individual income tax, with the notable exceptions of New York; Washington, D.C.; and Delaware.

[6] 740 Ill. Comp. Stat. 175/3(b)(2).

[7] Ind. Code section 5-11-5.5; R.I. Gen. Laws section 9-1.1-3.

[8] *International Game Tech. Inc. v. Second Judicial District*, 122 Nev. 132, 158-59 (2006).

[9] N.Y. Fin. Law section 189.4.

[10] *Spies v. United States*, 317 U.S. 492 (1943).

[11] There is legislation pending in the New York Legislature to expand the tax-based claims provision to cover nonfilers.

[12] N.Y. State Office of the Attorney General, "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).

[13] N.Y. State Office of the Attorney General, "A.G. Underwood & NYC Corporation Counsel Carter Announce $30 Million Settlement With Investment Manager for Tax Abuses" (Sept. 27, 2018).

[14] *See* Decision and Order on Motion, *State ex rel. RD Litigation Associates LLC v. B&H Foto & Electronics Corp.*, Index No. 452106/2019 (N.Y. Sup. Ct. Sept. 21, 2021); Decision and Order, *State ex rel. Saric v. GFI Breslin LLC*, Index No. 101812/2018 (Sup. Ct. N.Y. Cnty. Apr. 16, 2021).

[15] N.Y. State Office of the Attorney General, "Attorney General James Sues Sotheby's for Defrauding New York Taxpayers Out of Millions" (Nov. 6, 2020); "Attorney General James Secures $1.5 Million From Online Sports Retailer Fanatics for Under Collecting Sales Tax" (Oct. 19, 2021); and "Attorney General James and NYC Corporation Counsel Johnson Announce Recovery of $105 Million From Hedge Fund Manager Who Evaded Taxes" (Mar. 2, 2021).

[16] N.Y. State Office of the Attorney General, "Taxpayer Notice: Attorney General James Reminds Crypto Investors to Pay Taxes on Virtual Investments" (Mar. 23, 2022).

[17] 6 Del. Code Ann. section 1201.

[18] *See* D.C. Code Ann. section 2-381.02.

this legislation expired in March 2021, the District became the latest jurisdiction to enable tax-based FCA lawsuits. On May 10, 2022, the District's attorney general announced its first enforcement action under the new law, a relatively modest suit against a landowner who allegedly failed to pay tax on a vacant property.[19]

The big case would hit the papers a few months later, though. On August 31 the District announced an FCA suit for more than $25 million in unpaid income tax against Michael Saylor, cofounder and executive chairman of corporate bitcoin buyer MicroStrategy Inc.[20] According to the complaint, Saylor claimed to be a resident of other, lower-tax jurisdictions while living in a penthouse in Georgetown and keeping a yacht on the District's waterfront.[21] In light of the District's relatively high tax rates and the region's compact geography, D.C.'s revenue authority is no stranger to these sorts of residency fraud allegations. But no one would mistake this complaint for Office of Tax and Revenue work product. This is an operatic pleading document, in the New York attorney general's style, brimming with details and brandishing multiple photos of Saylor's boat, luxury building, and waterfront views. It raises the question whether a new era of tax enforcement is underway on the Potomac.

An Altered Tax Enforcement Ecosystem?

Let us return for a moment to the metaphor we opened with, the spotted lanternfly — the invasive species of plant-dwelling insect that is rapidly spreading throughout the Eastern United States, and that was so very much feared by state departments of agriculture that residents were advised to squash the bugs on sight. Thus arose such peculiar events as "lanternfly-killing bar crawls," as intrepid citizens rallied to the cause of protecting native plants and animals.[22] When actual data began coming in, though, the impact of the lanternflies seemed to be more muddled, and certainly less dramatic. It turns out that dogs can get really sick from eating these things and that some types of grapevines are severely affected, but other plants seem to manage, and through a complex chain of cause and effect, honeybees actually benefit. As Vox's environmental reporter noted, "Ecosystems are complicated, so introducing a new species can have all kinds of unexpected impacts."[23]

So what is going to be the impact of introducing these new species — whistleblowers and their counsel, and state attorney general offices — into the tax enforcement ecosystem? For many of us, there probably is no need for a cathartic bar crawl just yet. The most immediate impact is going to be limited by geography (to the eight jurisdictions and counting that have adopted some form of FCA tax provision) and subject matter (to the kinds of taxes that these states impose). There are also practical limits on how many FCA suits can be brought. These kinds of cases are resource-intensive endeavors, not least because FCA plaintiffs have to prove *mens rea* — not just that the defendants got the relevant tax propositions wrong, but that they knowingly made false claims, statements, or records — and state attorney general offices have a lot of competing demands on their resources. For these reasons, one shouldn't expect an avalanche of tax enforcement cases coming from state attorney general offices.

However, like the unfortunate dog who ingests a lanternfly, a taxpayer who comes into contact with an FCA lawsuit will certainly see the changes in the ecosystem as quite impactful. As cases like *Sprint* show, when a state attorney general office gets involved, it can quickly become the key player in a matter. These offices tend to be influential and heavy-hitting government components, headed either by an ambitious political appointee or an elected boss with an independent constituency and a need to develop a record to run on. Though the resources of attorneys general are not limitless, they often dwarf what a state revenue agency can bring to a

[19] D.C. Office of the Attorney General, "AG Racine Announces First Enforcement Action to Crack Down on Tax Evasion by Owners of Vacant & Blighted Houses" (May 10, 2022).

[20] D.C. Office of the Attorney General, "AG Racine Sues DC-Based Billionaire Michael Saylor & Software Company Microstrategy for Evading More Than $25 Million in District Taxes" (Aug. 31, 2022).

[21] D.C.'s Complaint in Intervention and Jury Demand, *District of Columbia v. Saylor*, No. 2021 CABSLD 001319 B at paras. 1-5, 19-24 (D.C. Super. Ct. Aug. 22, 2022).

[22] Jones, *supra* note 1.

[23] *Id.*

particular case, and in some circumstances the attorney general can also leverage a motivated whistleblower's resources to function almost as a sort of back office.

Moreover, as a practical matter, when a government entity must curate its cases and devote significant investigative resources to them, it may be all the more likely to vigorously pursue the cases it has selected. Similar to a white-collar criminal prosecutor's docket, assistant state attorneys general in an FCA unit are likely to be working on a relatively small number of cases that each require a significant amount of attention. In part because there are limits to how many cases can be brought, these state attorneys general tend to share a core aspect of the criminal prosecutor's worldview: Deterrence is key. This means that cases will sometimes be brought very publicly, with press releases and snappy pleadings language that is crafted for media circulation. Analogous to a criminal case, FCA remedies and settlements will be structured to send a message, not only to the taxpayer but also to the broader community.

In light of the rise of FCA tax evasion *qui tam* suits, tax controversy attorneys need to borrow their white-collar colleagues' FCA playbooks. As any FCA veteran will attest, there is a world of difference between litigating against a whistleblower alone and litigating against an attorney general who carries the whistleblower's case forward. If at all possible, it is critical to prevent the government's intervention — to rebut and discredit the whistleblower's theories if and as the facts allow, to convince the attorney general's office that there's no there there, or at least to keep the office ambivalent and on the sidelines. The investigation phase is where this kind of advocacy happens most naturally, as counsel will invariably look for opportunities to sprinkle seeds of doubt in between document productions and witness interviews. Whether in the pre-litigation/investigation phase, or if litigation ensues, or in the course of settlement negotiations, it is important to bear in mind the perspectives, methods, and policy objectives of the attorney general's office — which, again, can be different from how the more traditional tax enforcement players may perceive and approach similar matters.

The tougher question, and probably one that will take some time to fully resolve, is how FCA litigation will affect the positions that state revenue authorities (and possibly even the IRS or Justice Department) take with other taxpayers. Insofar as FCA cases are public and often relatively high-profile, it is hard to believe that there would be no impact when there is similar subject matter. Indeed, though one imagines there might be some degree of bureaucratic jockeying or at least culture clash, state attorneys general and state revenue authorities generally do coordinate when tax-based FCA cases are brought. When taxpayers in such cases reach settlement, they generally ink deals with both agencies. Thus, it seems only natural that revenue authorities will consider the resolution of these lawsuits in other cases presenting similar issues, even when they pursue exams and controversies in the old-fashioned way. Even in jurisdictions that don't allow tax-based FCA claims, state revenue authorities may well peek beyond state boundaries to consider the results of FCA litigation in other jurisdictions. Out-of-state revenue authorities are not necessarily going to adopt their neighbors' positions, but still, tax-based FCA cases are probably too high-profile — and for the moment, at least, too novel — to completely ignore.

Finally, query how an FCA suit alleging tax fraud, with all the publicity that it can generate, would affect criminal tax referrals, investigations, and prosecutions covering the same or adjacent subject matters. Would the publicity of an FCA suit, layered over interjurisdictional rivalries, tend to move criminal cases along when otherwise they might stall? Or might it instead create the sense that the subject matter at issue, either for a particular set of taxpayers or more generally, is more fit for civil than criminal enforcement? These are probably among the most difficult questions to grapple with, as they seem to hinge on big policy considerations and political and bureaucratic dynamics that are difficult to anticipate — to say nothing of the endless permutations of actual facts that may present.

As they say, ecosystems are complicated. ■